

1 STATE OF MISSOURI
2 PUBLIC SERVICE COMMISSION

3 PUBLIC HEARING
4 September 14, 1999
5 Jefferson City, Missouri
6 Volume 2

7 In the Matter of 4 CSR 240-80.015)
8 Proposed Rule - Electric Utilities) Case
9 Affiliate Transactions.) No. EX-99-442

10 In the Matter of 4 CSR 240-80.015)
11 Proposed Rule - Steam Heating) Case
12 Utilities Affiliate Transactions.) No. HX-99-443

13 In the Matter of 4 CSR 240-80.015)
14 Proposed Rule - Gas Utilities) Case
15 Affiliate Transactions.) No. GX-99-444

16 In the Matter of 4 CSR 240-80.015)
17 Proposed Rule - Gas Utilities,) Case
18 Marketing Affiliate Transactions.) No. GX-99-445

19 BEFORE:

20 KEITH THORNBURG, Presiding,
21 REGULATORY LAW JUDGE.
22 HAROLD CRUMPTON,
23 CONNIE MURRAY,
24 ROBERT G. SCHEMENAUER,
25 M. DIANNE DRAINER, Vice-Chair
COMMISSIONERS.

REPORTED BY:

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1 P R O C E E D I N G S

2 (Written Entries of Appearance filed.)

3 JUDGE THORNBURG: Go on the record now.

4 Good morning. My name is Keith Thornburg.

5 I'm the law judge that's been assigned to this
6 rulemaking proceeding today.

7 Today is September 14th, 1999. We are
8 convening a rulemaking hearing on a proposed rule
9 applicable to affiliate transactions in the electric
10 utility industry. The style of the proceeding is, "In
11 the Matter of the Missouri Public Service Commission's
12 Proposed Rule Regarding Affiliate Transactions for
13 Electric Utilities, Case No. EX-99-442." The proposed
14 rule number is 4 CSR 240-20.015.

15 First, I'd like to point out that this is a
16 public hearing regarding the proposed rulemakings.
17 We're here today to take comments from the public
18 regarding the proposed rule. Attorneys may appear
19 today in a representative capacity. If you are
20 appearing in a representative capacity, I'd ask that
21 you complete a written entry of appearance and that
22 you also reidentify yourself and your clients on the
23 record.

24 You may be -- you will be able to make an
25 opening statement today that will be brief. Later in

1 the hearing, you may offer substantive comments that
2 include facts or argument. I will, if possible, call
3 on you in the same order that I call for opening
4 statements.

5 The Commission and I, or I, might question
6 you, and then at the time you are called for comments,
7 you may also present any witnesses that you have
8 brought with you for the hearing.

9 Anyone who wishes to appear and offer
10 comments but is not acting as an attorney in a
11 representative capacity should sign the witness list.
12 Witnesses will be sworn in, including attorneys who
13 are appearing solely as a witness.

14 Because this is a rulemaking proceeding,
15 objections to the testimony of the witnesses will not
16 be taken, and all of the questioning will be from the
17 Bench.

18 The order of opening statements and
19 witnesses today will be proponents first and opponents
20 second. I've prepared a list of participants based on
21 the preregistration for the hearing. I'm going to
22 work down that list first, if I can today, and then
23 I'll take -- anyone that's signed in for the first
24 time today, I'll take them at that time.

25 Some participants have indicated that they

1 would like their comments today incorporated into the
2 records for the steam heating affiliate transactions
3 case, No. HX-99-443, or in the gas affiliate or gas
4 marketing affiliate transaction case numbers GX-99-444
5 and GX-99-445.

6 If that's the case, then the witness or
7 attorney should indicate the cases where they want
8 that testimony reproduced, and I've instructed the
9 court reporter to reproduce that as an exhibit to the
10 transcript for that particular rulemaking record.
11 It's my preference not to do this for the opening
12 statements unless that presents a hardship to you.

13 After a witness has initially appeared and
14 testified, it's possible that the Commission or I may
15 ask questions later in the hearing for that witness.
16 Those later comments won't automatically be
17 incorporated, just the initial comments and
18 questioning.

19 If a participant later decides to have
20 hearing comments or opening statements in the record
21 considered in one of these other cases that have not
22 already been offered as an exhibit today, you can make
23 a written request later to have that testimony or
24 statement reproduced in that record. You'll need to
25 identify the page number and the line number of the

1 material, or you'll need to reproduce that in your
2 written request.

3 I think before I take any other questions or
4 go on today, I'd like to take on-the-record entries of
5 appearance so we can get the attorneys that are here
6 today. And I'll work off of the list I have, and then
7 we'll see who else we have.

8 For the Public Service Commission Staff?

9 MS. SHEMWELL: Lera Shemwell, Post Office
10 Box 360, Jefferson City, Missouri for the Staff of the
11 Public Service Commission.

12 JUDGE THORNBURG: Okay. Just your name and
13 party. If you've filled a written entry, then we have
14 the address.

15 JUDGE THORNBURG: Public Counsel?

16 MR. COFFMAN: Appearing on behalf of the
17 Office of the Public Counsel, John B. Coffman and
18 Douglas E. Micheel, P.O. Box 7800, Jefferson City,
19 Missouri, 65102.

20 JUDGE THORNBURG: Enron.

21 MR. JOHNSON: Yes. Robert C. Johnson,
22 appearing on behalf of Enron.

23 JUDGE THORNBURG: Okay. Do we have anyone
24 here from Mountain Energy today?

25 (No response.)

1 JUDGE THORNBURG: Are there any other
2 proponents with attorneys here today?

3 MR. DOWNEY: Yes. Ed Downey, on behalf of
4 the Missouri Industrial Energy Consumers, MIEC.

5 JUDGE THORNBURG: Okay. Opponents.
6 AmerenUE?

7 MR. NIEHOFF: William Niehoff, Ameren
8 Corporation and AmerenUE.

9 MR. FAGAN: And Shawn Fagan, Ameren
10 Corporation and AmerenUE.

11 JUDGE THORNBURG: Kansas City Power & Light
12 Company?

13 MR. REYNOLDS: Gerald Reynolds and Bill
14 Riggins, on behalf of Kansas City Power & Light
15 Company.

16 JUDGE THORNBURG: The Edison Electric
17 Institute?

18 MR. WILLIAMS: Good morning. Johannes W.
19 Williams, on behalf of the Edison Electric Institute.

20 JUDGE THORNBURG: Are there other opponents
21 here today?

22 MR. DUFFY: Gary Duffy, appearing for
23 St. Joseph Light & Power Company, the Empire District
24 Electric Company, and Utilicorp United, Inc., doing
25 business as Missouri Public Service.

1 JUDGE THORNBURG: Anyone else?

2 (No response.)

3 JUDGE THORNBURG: I wanted to just mention

4 for Kansas City Power & Light and Public Counsel,

5 there is still a discovery request pending, and I'm

6 not prepared to rule on that today, but --

7 MR. COFFMAN: That's correct. That's kind

8 of a chief dispute. We do not intend, I guess, to use

9 that in any presentation today, the content there, but

10 if the Commission wishes to review that information

11 itself, though, I would encourage the Commission to

12 grant the motion.

13 JUDGE THORNBURG: Okay. And, I guess,

14 Mr. Reynolds, you are still opposed to producing that?

15 MR. REYNOLDS: That's correct.

16 JUDGE THORNBURG: Okay. And we'll rule on

17 that and make arrangements if the Commission needs to

18 see that.

19 I think at this time, unless there is any

20 questions, we'll recess until 10:15, and I'll bring

21 the full Commission in and we'll start the public

22 hearing. And -- well, 10:15. Thank you.

23 (A RECESS WAS TAKEN.)

24 JUDGE THORNBURG: Let's start with the

25 Staff, Lera Shemwell.

1 MS. SHEMWELL: I won't repeat my statements
2 from yesterday. But Commissioner Murray had some
3 questions about growth of affiliate transactions, and
4 I would like to point out the annual reports of both
5 KCP&L and Ameren and just briefly mention a couple of
6 things.

7 KCP&L is talking about one of its new
8 affiliates KLT, and it says that, "KLT's mission is to
9 aggressively develop nonregulated businesses providing
10 significantly higher growth in value than KCP&L's
11 regulated businesses." They "strategically invests in
12 and manages businesses, capitalizing on KCP&L's
13 demonstrated core competencies and experiences; pursue
14 opportunities by combining our expertise with
15 knowledgeable partners."

16 Mr. Jennings writes that, "KLT, Inc.", which
17 is one of their energy services subsidiary, "recently
18 helped form Nationwide Electric, Inc., an aggregator
19 of electrical contracting and maintenance companies
20 servicing commercial and industrial clients." So they
21 are beginning to develop more of these. That has been
22 very recent.

23 Ameren also is entering into other areas.
24 This is the chairman's letter, and he says, "We
25 continue to grow earnings through core business

1 development . . ." He says, "We are developing a
2 stream of attractive products and services that will
3 benefit our customers and enhance other company's
4 earnings growth. These include a number of
5 technologically sophisticated products, from an
6 automated bill consolidation service - Ameren
7 Abillity" -- and that's spelled with two Ls -- "to an
8 energy management product - Ameren Abacus - that
9 allows business or institutional customers to track
10 energy use by process, building or facility." These
11 are fairly new ventures for these two companies.

12 This is one of Ameren's as well: "Gateway
13 Energy is a joint venture of Ameren, Environmental
14 Management Corp. and Energy Equities. Gateway Energy
15 has several pending projects, including management of
16 an energy center for a major office and research
17 campus."

18 "Ventures likes this one, attractive
19 products and services, coupled with a continued focus
20 on our cost control, will allow our company to
21 capitalize on our strong fundamentals, while pursuing
22 selective solutions. Given these strengths, we are
23 confident of our ability to manage the changes that
24 are reshaping our industry."

25 So my point is that utilities are continuing

1 to expand into nonregulated areas that they believe
2 will help their bottom line.

3 Thank you.

4 JUDGE THORNBURG: Thank you.

5 Mr. Coffman, with the Office of the Public
6 Counsel?

7 MR. COFFMAN: Thank you.

8 May it please the Commission?

9 For several years now, Public Counsel has
10 been calling upon the Commission to establish
11 affiliate transaction standards in Missouri, and as
12 electric utilities rush to diversify and expand into
13 new nonregulated enterprises in order to meet current
14 and anticipated changes in their industry, there are
15 very real and significant threats to those captive
16 electric customers on the regulated electric side.

17 As the Commission deliberates upon the
18 issues today, I think it's important to just briefly
19 look back on how we got here.

20 For as long as I've been practicing here,
21 the Commission has wrestled in rate cases and in other
22 forums with the challenge of protecting the public
23 from cost shifting that results in captive customers
24 subsidizing nonregulated affiliate enterprises. And
25 approximately five years ago, Public Counsel proposed

1 these types of rules in a series of utility-specific
2 Commission cases. Those utilities objected, claiming
3 that the matter should be addressed in a more generic
4 proceeding. Ironically, some of those utilities will
5 tell you that they now believe contested cases are the
6 best forum for addressing these issues.

7 Without rehashing the legal issues here, I
8 will just simply assure the Commission that it is on
9 solid footing in its decision to pursue a rulemaking
10 proceeding. The Staff has accurately cited and
11 properly researched the authority that you do hold to
12 promulgate the proposed rules for the benefit of the
13 public. I think the proper analogy to this quasi
14 legislative proceeding would a legislative committee
15 hearing.

16 In April 1996, the Commission established a
17 docket 00-96-329 to obtain comments regarding an
18 overriding affiliate transaction rule. After a
19 certain amount of comments and meetings, the
20 Commission closed that case and opened another,
21 OX-98-183. And after numerous technical workshops and
22 more comments from stakeholders, the Commission
23 decided to close this case and pursue rules that
24 established standards of conduct for each industry
25 individually. More workshops over the following year

1 took us up to these rulemaking dockets that we are
2 hearing today.

3 While affiliate transaction rules are long
4 overdue, the painstaking process that led up to this
5 hearing has been productive from our perspective.
6 Public Counsel has been able to review affiliated
7 transaction rules adopted in numerous other states; we
8 have found more examples of activities which
9 illustrate the urgent need for such rules in Missouri,
10 and we have carefully drafted some proposed rules that
11 we believe improve upon and clarify the well-thought-
12 out proposed rules that the Commission has proposed.

13 Of course, the cleanest and most certain and
14 most cost-effective way for the Commission to protect
15 the public from the dangers of cross-subsidization
16 would be simply to require structural separation of
17 nonregulated affiliates from the regulated monopolies.
18 The second best and less restrictive solution is to
19 promulgate record-keeping requirements and behavioral
20 rules in the manner the Commission has proposed.

21 Public Counsel's proposed rules contain
22 several clarifications and additions that we hope the
23 Commission will give serious consideration. These
24 suggestions were developed over the past months and
25 with great care.

1 We developed these with the purpose of
2 providing rules that would have -- provide unambiguous
3 guidance to the utilities reducing the potential for
4 future agreements about interpretations of the rule.
5 We developed our proposed rules based on a survey of
6 the efforts in other states and what has been done to
7 address similar problems.

8 We've studied the recent NARUC guidelines
9 for cost allocations and affiliated transactions. We
10 are not trying to reinvent the wheel, and have tried
11 to incorporate ideas that are based on tested
12 concepts. By comparison we believe that our proposals
13 are moderate and narrowly tailored to the problems
14 being addressed.

15 We've also tried to tailor our proposals to
16 the regulated electric industry as it now exists in
17 Missouri. Our experts have extensive experience and
18 knowledge of the operations and challenges faced by
19 these companies, and we want our proposals to fit our
20 state.

21 We are offering two commenters today.
22 First, of all, James Dittmer of Utilitech,
23 Incorporated. He is no stranger to most of you here.
24 He began his regulatory career with the Commission in
25 1975 and has performed consulting work for the

1 Commission, or at least his firm has performed work
2 for the Commission Staff on numerous occasions.

3 He's developed a broad experience in
4 affiliated transaction issues while consulting in
5 several states, and he has done considerable
6 consulting in Missouri.

7 He will comment regarding the general
8 regulatory theory supporting the affiliated
9 transaction rules. He will point out some of the
10 clarifications and modifications that we are
11 recommending to the Commission's proposed rule, and he
12 will be available to answer any questions specifically
13 about the asymmetrical pricing provision.

14 We will also provide for questions Ryan
15 Kind. He is Public Counsel's chief economist
16 regarding energy issues. His extensive discovery in
17 this case and other Commission's dockets has given him
18 unique insight into the issues that we're discussing
19 today.

20 While he has not performed a thorough audit
21 of all affiliated transactions in Missouri, our
22 discovery has uncovered some very relevant information
23 about the urgent need for the affiliate transactions
24 rule.

25 Mr. Kind will be available to discuss recent

1 trends in diversification within the industry as well
2 as any specific examples of utility practices in
3 Missouri that you may wish to inquire about, and which
4 we believe threaten to harm customers of regulated
5 electric service.

6 In conformance with the practice the
7 Commission used yesterday, we would ask that the
8 transcript of our two commenters today be marked and
9 incorporated into the record of the other three
10 rulemaking cases, if that's appropriate.

11 JUDGE THORNBURG: Thank you.

12 MR. COFFMAN: Thank you.

13 JUDGE THORNBURG: Mr. Johnson, do you have
14 an opening remark?

15 MR. JOHNSON: I have a brief statement.

16 My name is Robert C. Johnson. I'm here
17 representing Enron Corporation. And we're appearing
18 today in -- with respect to all three of the dockets
19 that are scheduled for hearing today and tomorrow.
20 That's EX-99-442, GX-99-444 and GX-99-445.

21 I have with me today Thomas Reichelderfer,
22 who is a manager of state government affairs for Enron
23 Corporation. Mr. Reichelderfer has prepared extensive
24 comments and filed these comments in all three of
25 these dockets. He will be available to respond to any

1 questions that the Commissioners may have.

2 I'd like to clarify one issue. There was
3 some concern expressed in some of the comments that
4 the Enron comments related only to competitive
5 affiliate transactions. That's incorrect. They also
6 would apply to noncompetitive affiliate transactions.

7 I wanted to make that clear on the record.
8 There was no intent to limit it to the competitive
9 subsidiaries and affiliates.

10 If you have any particular questions, I
11 would be happy to attempt to respond to them, but the
12 client here will be in a position to respond to the --
13 comment on his own comments and also to respond to any
14 questions you might have. Thank you.

15 JUDGE THORNBURG: Thank you, Mr. Johnson.

16 Mr. Downey, do you have an opening
17 statement?

18 MR. DOWNEY: May it please the Commission?

19 My name is Ed Downey. I represent the
20 Missouri Industrial Energy Consumers, MIEC. I'll be
21 very brief.

22 MIEC supports the Commission's efforts to
23 address this consumer issue. The MIEC supports the
24 Office of Public Counsel and their articulate and
25 well-reasoned written comments, as well as those of

1 Enron. The MIEC filed some brief written comments.
2 That will be it. We'll present no further testimony
3 today or other comments. Thank you.

4 JUDGE THORNBURG: Thank you.

5 Is there any other proponent attorneys here
6 today?

7 (No response.)

8 JUDGE THORNBURG: Mr. Shawn Fagan?

9 MR. FAGAN: Good morning.

10 My name is Shawn Fagan. I'm here on behalf
11 of Ameren and AmerenUE.

12 I would like my comments incorporated into
13 all four dockets today, like everyone else.

14 Basically, although we will be testifying
15 later on this afternoon as opponents of the rules,
16 Ameren is not opposed to rules governing utility
17 affiliate transactions. In fact, Ameren believes that
18 some rules are necessary. The disagreement that we
19 have with some of the parties here is with regard to
20 the scope of those rules.

21 Ameren has in its comments proposed rules to
22 which it gave considerable thought and comments
23 that -- the written comments that we've submitted in
24 all four dockets explain why those rules are, we
25 think, the best rules for proving consumer welfare.

1 This afternoon we will have two witnesses.
2 I will provide comments on legal issues and also some
3 thematic comments, and Dr. John Landon, an economist
4 with extensive experience in the electric utility
5 industry and other utility industries, will provide
6 comments on economic issues related to the utility
7 affiliate transaction rules.
8 I'll save any other substantive comments
9 until that time. Thank you.
10 JUDGE THORNBURG: Thank you.
11 Gerald Reynolds?
12 MR. REYNOLDS: Good morning.
13 On behalf of Kansas City Power & Light
14 Company, I would like to thank the Commission for
15 providing the Company with an opportunity to share
16 some of its views on these important issues.
17 I don't have much to say this morning other
18 than to introduce our witness. The Company will be
19 represented by Stephen Mahinka. He is a partner at a
20 Washington, D.C. law firm. His testimony will include
21 issues such as antitrust matters and also competitive
22 efficiency issues.
23 Now, with respect to specific questions
24 regarding KCP&L's practices, we have Patrice Tribble,
25 who will answer any questions regarding the Company's

1 unregulated activities; Mark English, who will answer
2 any questions relating to KLT, which is a wholly-owned
3 subsidiary of KCP&L, and, finally, Christine Davidson,
4 who can answer any questions relating to accounting
5 issues.

6 Finally, I just want to point out that our
7 witness has a flight that will leave in the early
8 afternoon, and we would ask that he be permitted to go
9 early in the afternoon so he can make his flight.
10 Thank you.

11 JUDGE THORNBURG: Thank you.

12 Mr. Duffy?

13 MR. DUFFY: Let's see. This is Tuesday, so
14 this must be electric.

15 I'm here today on behalf St. Joseph Light &
16 Power, the Empire District Electric Company, and
17 Utilicorp's Division Missouri Public Service.

18 My comments are going to be very brief.

19 I'd like to respond, I guess, briefly, to
20 what Ms. Shemwell produced in the way of comments
21 about new affiliate transactions. I didn't -- I think
22 that was in response to a question yesterday about
23 what's going on in the heating -- steam heating world.
24 I didn't hear any reference to any steam heating
25 affiliates in what she was talking about.

1 And I believe my learned friend Mr. Coffman
2 has missed the point when he said that some of the
3 utilities were arguing for a contested case approach
4 in this hearing.

5 What we did was we said that you needed to
6 adopt contested case procedures in the context of the
7 rulemaking dockets themselves. I don't believe any of
8 my clients have advocated that the Commission should
9 try to adopt affiliate transaction rules on a
10 case-by-case in a rate-case type environment. We have
11 said, yes, you can certainly entertain this in a
12 rulemaking, but because the statute says you are
13 supposed to have a hearing at which evidence is
14 provided that we believe the law says you have to
15 entitle people to contested case procedures.

16 So on that note, I would reiterate the
17 objection that I made yesterday as to the swearing of
18 witnesses because we believe that's inconsistent with
19 your ruling on our denial -- on your denial of our
20 motion for contested case procedures.

21 Other than that, my clients do not have any
22 witnesses to produce today and would refer you to the
23 written comments that they have previously filed.

24 JUDGE THORNBURG: Thank you.

25 COMMISSIONER MURRAY: Judge, may I ask a

1 question?

2 JUDGE THORNBURG: Yes. Mr. Duffy?

3 MR. DUFFY: Yes, ma'am.

4 COMMISSIONER MURRAY: Just one question,

5 Mr. Duffy. If we did not swear the witnesses, would

6 that take care of your objection?

7 MR. DUFFY: Yes, ma'am.

8 COMMISSIONER MURRAY: Okay.

9 MR. DUFFY: Absolutely.

10 Anything else?

11 JUDGE THORNBURG: No.

12 I just want to point out, I'll come around

13 to the attorneys again, so if you have any comments in

14 response to anything in opening statement, you'll get

15 another shot at it. Just make a note.

16 MR. COFFMAN: That's fine.

17 JUDGE THORNBURG: Johannes Williams?

18 MR. WILLIAMS: Thank you, Judge Thornburg,

19 and good morning Commissioners.

20 Johannes Williams of the Edison Electric

21 Institute. Thank you for the opportunity to appear

22 before you today.

23 Edison Electric Institute is the national

24 trade association for the investment-owned electric

25 utility industry. We have central Missouri members

1 who are also appearing before you today, Ameren,
2 Kansas City Power & Light, Utilicorp, St. Joseph Light
3 & Power, and Empire District.

4 I would respectfully request that these
5 remarks that I'm going to provide to you, as well as
6 our witness later today, be incorporated in all of the
7 proceedings on affiliate transaction that the
8 Commission is currently considering, the gas
9 affiliate, gas marketing, and steam district
10 proceedings, as well as this.

11 EEI filed initial and reply comments in this
12 proceeding, and Dr. Matthew J. Morey, our director of
13 economic policy, will be EEI's witness later today.

14 EEI has appeared in over 30 proceedings in
15 more than 20 states on affiliate transactions in close
16 conjunction with our members to try to assist
17 commissions in reaching fair and equitable rules
18 regarding efficient competition in every aspect of
19 ongoing regulatory developments. We have done so in a
20 manner in which we seek to aid the Commission's
21 deliberative process by providing the perspective as a
22 national trade association.

23 I should add that EEI's members -- a super
24 majority of EEI's members determine EEI's overall
25 approach to competition although some members may

1 disagree with that approach in some instances.

2 I would also like to recognize Louis Harris,
3 a senior policy analyst in the Department of Economics
4 at EEI who is also in the hearing room today. Thank
5 you.

6 JUDGE THORNBURG: Thank you.

7 Are there any other opponents' attorneys
8 which wish to make an opening statement?

9 (No response.)

10 JUDGE THORNBURG: Ms. Shemwell, do you have
11 a witness you wish to present at this time, or any
12 additional comments? I'll start with the comments.

13 MS. SHEMWELL: I believe the witnesses
14 should be sworn. The Commission is to take evidence
15 as to reasonableness, and I believe the witnesses
16 should be sworn in order to give their evidence as
17 reasonable.

18 We have Dr. Michael Proctor this morning.
19 He has been to the dentist, and so he is not really
20 quite able yet to testify. If we could pass until
21 just a little later, I imagine that would be wearing
22 off. And I don't want him spitting on the court
23 reporter, so we would like to delay him just a little
24 while.

25 JUDGE THORNBURG: We can do that.

1 Did you have another witness?

2 MS. SHEMWELL: Not at this time. Thank you.

3 JUDGE THORNBURG: Mr. Coffman?

4 MR. COFFMAN: Yes. We would be happy to go

5 ahead with our commenters.

6 JUDGE THORNBURG: Yes.

7 MR. COFFMAN: I would like to make a brief

8 comment in regard to the objection about making

9 commenters swear an oath. I'm not aware of any legal

10 requirement that commenters be sworn in in a

11 rulemaking proceeding, but I see absolutely no harm or

12 error that would occur as a result, assuming that all

13 commenters have come here today with the intent of

14 telling the truth.

15 JUDGE THORNBURG: I'm not sure we can even

16 address this today. Current Commission procedure

17 rules do require the swearing of witnesses and

18 commenters in a rulemaking proceeding.

19 MR. COFFMAN: That's --

20 JUDGE THORNBURG: I don't know if I brought

21 that with me. It's in the CSRs. It's Subsection 7 to

22 whatever the rulemaking rule is, and it does provide

23 that commenters will be sworn. That's one of the

24 requirements.

25 MR. COFFMAN: Perfectly fine with us.

1 And we would -- I guess our first commenter
2 would be James Dittmer.

3 JUDGE THORNBURG: All right. Mr. Dittmer,
4 come to the stand.

5 (Witness sworn.)

6 JUDGE THORNBURG: Thank you.

7 You may be seated.

8 Mr. Dittmer, you will be able to offer
9 comments today, but you may want to start out with
10 just a brief introductory remark. And after you've
11 presented your comments, we may have some questions
12 for you.

13 MR. DITTMER: Very good.

14 Judging from the volume of initial as well
15 as reply comments that the OPC has filed, one might
16 conclude that OPC is opposed to the rules or has
17 somehow concluded that they are vastly deficient or
18 perhaps errant. However, in general, the OPC is very
19 supportive of the proposed rules as originally issued.
20 Conceptually, the OPC agrees with every component
21 included in the rule.

22 That having been stated, I would elaborate
23 by stating that the potential problem with the
24 proposed rules, as the Public Counsel views them, is
25 that they leave many items to interpretation. This

1 may have been by design by the Commission Staff. The
2 Staff of the Commission may desire to only establish
3 concepts or guidelines and leave decisions on
4 individual facts, points and scenarios to later
5 hearings, and certain issue could be dealt with in
6 such a manner on a case-by-case or issue-by-issue
7 basis. However, the OPC does see merit in clarifying
8 things further at this point in time.

9 I guess this is one of the relatively
10 infrequent occurrences where the OPC is at least
11 somewhat sympathetic to certain utilities' claims of
12 vagueness and uncertainty in interpreting the rules.
13 Accordingly, the OPC has filed fairly significant
14 comments that the OPC believes will clarify and define
15 the rules.

16 Again, the modifications proposed we do not
17 believe conflict with the rules as now proposed,
18 rather, that they largely and simply specify and
19 clarify actions and conduct that would be considered
20 noncompliant or compliant with the rules.

21 Specifically, Section 2.B of the proposed
22 rules state very briefly and succinctly that, "The
23 regulated electrical corporation shall conduct its
24 business in such a way as not to provide any
25 preferential service, information or treatment to an

1 affiliated entity over another party at any time."
2 Arguably, this very brief and sort of all-
3 encompassing language and language that I consider to
4 be a conceptually correct guideline provides all of
5 the information and direction the utilities need.
6 However, I believe legitimate confusion could arise as
7 to what might constitute or be considered preferential
8 service, preferential information or preferential
9 treatment. Accordingly, the OPC has offered specific
10 guidelines as to what is and is not considered
11 preferential service, information and treatment.
12 Specifically, OPC has set out guidelines
13 regarding appropriate or inappropriate conduct that
14 can occur between the affiliates and the utilities. I
15 won't go through them in detail but just note briefly
16 that some of the areas are what information, customer
17 information and other information, can be exchanged
18 and not exchanged, what business development and
19 customer relations practices are acceptable and not
20 acceptable, the prohibition of use of identical or
21 similar names in logos, prohibitions on doing
22 advertising and marketing, prohibitions on tying
23 quality or price of utility service to taking of goods
24 and services from the utility's affiliates, and a
25 requirement that the utility and affiliate must

1 function independently.

2 Again. All of those subparts to OPC's
3 proposed Section 2 are intended to clarify and define
4 what would constitute preferential treatment or
5 noncompliance with the affiliate transactions rules.

6 I stated most of OPC's suggested changes or
7 modifications were in the nature of clarification
8 rather than proposing a conceptual difference to the
9 proposed rules.

10 The OPC has proposed one fairly significant
11 addition to the rules that I'm not sure falls in the
12 category of a clarification or perhaps a true
13 amendment. Specifically, OPC has proposed to define
14 and specifically exempt corporate support functions
15 from the affiliate transaction rules.

16 The reason I say I'm not sure if it is an
17 amendment or clarification is because I'm not sure if
18 Staff intended or agrees that corporate support
19 functions do not constitute a preferential service.
20 If the Staff also believes that the utilities should
21 be permitted to carry out corporate support functions
22 without all of the reporting and pricing requirements
23 of the rules, I would classify this OPC addition as
24 merely a clarification.

25 In any event, OPC has defined corporate

1 support function -- corporate support activities to
2 include oversight, government, support systems,
3 personnel involving payroll, shareholder services,
4 financial reporting, human resources, employee
5 records, pension management, legal services, and
6 nonmarketing research and development activities, all
7 which would be exempted from affiliate transaction
8 pricing, rules of conducts, et cetera, et cetera.

9 Some utilities argued in their initial
10 comments that the proposed rules were oppressive and
11 burdensome and costly to implement, often citing the
12 problems caused by corporate support functions which
13 were not exempted in the rules specifically, that --
14 they argued that this burden would -- that they would
15 have to provide all of these services to their
16 competitors.

17 The exemption for the corporate support
18 function alleviates most and perhaps all of the
19 utilities' legitimate gripes about the burden and
20 unfairness of the rules. While not in OPC's original
21 or initial comments, the OPC has even recommended in
22 our reply comments that utilities be exempted from
23 even having to obtain a fair market value for these
24 services. They merely have to follow fully
25 distributed cost methodologies for assigning costs for

1 these services.

2 Finally, on the topic of corporate support
3 functions, I would emphasize that the exemption should
4 allow for and facilitate facilities to achieve
5 economies of scale and scope through diversification
6 and growth, something which many of the utility
7 respondents argued that the proposed rules would
8 prevent.

9 Another topic I would like to address just
10 briefly is the need for and equity of the asymmetrical
11 pricing provisions embodied within the proposed rules.
12 Briefly, the asymmetrical pricing rules provide when a
13 utility sells a non-tariffed good or service to the
14 affiliate, it should do so at the higher of the fully
15 distributed cost amount or fair market value.
16 However, when the utility purchases a good or service
17 from the affiliate, it should be at the lower fully
18 distributed cost or fair market value.

19 And on its face, and probably at most
20 readers' first impression, such a provision would
21 appear unfair. However, to appreciate the need and
22 equity of such provision, the individual piece parts
23 need to be analyzed and considered.

24 First, sort of the easy ones, a utility
25 should never pay more than the lower of the fully

1 distributed cost or market for a good or service
2 purchased from an affiliate. Clearly, just as a
3 utility should buy a good or service when the market
4 prices is below its internal cost of producing or
5 serving, it should do so in order to lower its cost of
6 service.

7 Similarly, if an affiliate's fully
8 distributed cost is above market, the utility should
9 not pay more than the market price in order to, again,
10 lower its cost of service.

11 If the FDC is lower than the market price,
12 the utility should also obtain this lower price. The
13 reason for paying the lower fully distributed cost is
14 the presumption that if the affiliate can obtain a
15 lower price than the market for producing -- a price
16 lower than market for a good or service by
17 internalizing the production or service, then to --
18 the logic follows that the utility should be able to
19 internalize such functions at a price below market.

20 In fact, just as the regulator would expect
21 the utility to internalize any activity that it can --
22 that can be done so for less than a market price, so
23 then should the utility pay the lower fully
24 distributed price to the affiliate.

25 Regarding the charging of the higher of the

1 fully distributed cost or market when sales are made
2 to an affiliate, one must consider and remember that
3 utilities have an obligation to lower the cost of
4 service to utilities whenever possible. Most
5 commissions expect utilities to maximize revenues from
6 nonregulated sales to nonaffiliates in order to be
7 able to credit such revenues to the cost of service.
8 Examples of such activities include temporary or
9 seasonal energy or capacity opportunity sales to other
10 utilities and also pole rentals to phone and cable
11 companies.

12 Just as the utility should maximize revenues
13 from sales to nonaffiliates by charging whatever the
14 market will bear, so should it maximize revenues by
15 charging the market price to its affiliates whenever
16 the market price exceeds its cost.

17 Finally, utilities should strive to always
18 recover their costs, and, accordingly, if for some
19 reason the market price is below the utility's fully
20 distributed cost to provide a good or service, it
21 should, nonetheless, charge the affiliates the fully
22 distributed cost to provide the good or service.

23 Some of the utilities have argued for other
24 pricing standards including stricter adherence to
25 market prices or in some cases incremental costs. And

1 certainly one can conjure up examples where strict
2 adherence to asymmetrical pricing could have the
3 result that would not be in the best interest of the
4 ratepayers.

5 It is for that reason that the proposed rule
6 provides for a variance. In those hopefully fairly
7 rare or infrequent occasions, a utility should
8 request, and, presumably, the Commission would endorse
9 a variance. Again, I believe the proposed rules are
10 generally sound and equitable for reasons just stated;
11 however, if the facts warrant an exception, it should
12 be addressed within a variance.

13 Finally, on the topic of asymmetrical
14 pricing, I note and emphasize that asymmetrical
15 pricing has been adopted by other federal and state
16 regulatory commissions, and most recently the NARUC
17 has endorsed affiliate transaction guidelines that
18 support asymmetrical pricing provisions.

19 So the asymmetrical pricing standards are
20 not new, unique or radical in nature. They have been
21 previously adopted by several regulators and the
22 NARUC.

23 Finally -- the final topic I would like to
24 just briefly mention is the Ameren and UE proposal,
25 that it be exempted from affiliate transaction pricing

1 and certain conduct rules given it has already in
2 place a general services agreement.

3 I note and emphasize that I have not read
4 the Ameren general services agreement, but the
5 comments -- the write-up, including the Company's
6 comments and the Company's reference to SEC rules,
7 which the GSA apparently follows, leads me to conclude
8 that the GSA is probably consistent with fully
9 distributed costing allocations.

10 When one considers that many of the
11 activities carried out by the Ameren Service
12 Corporation are corporate support functions, which are
13 already exempted from the rules, I really don't see a
14 big conflict or a large discrepancy between the
15 proposed rules and Ameren's existing GSA.

16 Finally, a note on this topic is other
17 intervenors and Staff have noted the merger agreement
18 with UE and CIPSCO, specifically, made the GSA
19 subservient to any Commission-imposed rules.

20 And that's the conclusion of my opening
21 comments.

22 I would note that in OPC's initial comments
23 we seem to have an extraneous paragraph on the bottom
24 of Page 17. It was, I believe, intended to hit
25 another code of conduct that never made its way to the

1 rules, so I would encourage the readers to ignore the
2 last paragraph on Page 17 of our initial comments.

3 JUDGE THORNBURG: Thank you.

4 Commissioner Crumpton, do you have any
5 questions?

6 COMMISSIONER CRUMPTON: No questions.

7 JUDGE THORNBURG: Commissioner Murray?

8 COMMISSIONER MURRAY: Thank you.

9 QUESTIONS BY COMMISSIONER MURRAY:

10 Q. Good morning.

11 A. Good morning.

12 Q. The exception of the corporate support
13 functions that you talked about with your -- OPC's
14 proposal, as you read the rule as it's currently
15 proposed, there is nothing that sets out corporate
16 support functions as being exempt; is that correct?

17 A. It's not specifically delineated. I think I
18 read the Staff's reply comments where they -- at least
19 at one part they seem to be claiming that they think
20 it definitionally falls outside the rules.

21 My response to that is, fine, but why don't
22 we just clarify it so it's not subject to
23 interpretation, if, in fact, that's their intent also?

24 Q. Okay. So the language that you offered in
25 terms of corporate support would take care of that

1 concern, as far as OPC is --

2 A. Yes.

3 Q. And in terms of your interpretation of
4 variances, do you interpret the rule as it is proposed
5 to allow for variances on a transaction-by-transaction
6 basis only or to also allow for variances on a
7 company-by-company basis?

8 A. I'm not -- actually, I'm not -- I think it
9 would be interpreted different ways.

10 What I would hope the interpretation would
11 be is that if a particular product or service for a
12 given utility, you come and get an exemption for a
13 particular type series of transactions between a
14 utility and its affiliate, you need a variance for
15 that. If KCP&L decides to start making -- or
16 distributing poles that for some reason it feels that
17 rigid adherence to the asymmetrical pricing would lead
18 to a conclusion that we just aren't going to transact
19 business between the affiliate and the utility, you
20 could hopefully get that whole thing exempted.

21 You might have a cutoff at the time of the
22 variance where we're going to accept this as a
23 variance for the next two years and then we'll look at
24 it again the next three years, that's the way I would
25 like to see it interpreted.

1 Q. You would not want it interpreted, then,
2 that a company could come in and say, we would like a
3 variance from the rule, period?

4 A. Oh, I don't think so. No, no.

5 Q. On Page 12 of the reply comments of Office
6 of Public Counsel, the last paragraph on that page
7 speaks about imposing minimum thresholds in compliance
8 with the rules. And I would like to know, would you
9 recommend that we have a minimum threshold?

10 A. Well, I'm not really recommending it,
11 per se. I'm simply saying that if you -- if after
12 hearing all of these comments the utilities -- which
13 I'll be hearing the first time with you -- make a more
14 convincing plea that it's going to cost us more to
15 implement these rules than any value it could get out
16 of it, then a logical fallback position would be to
17 say, okay, let's -- in addition to the corporate
18 support function, which should take care of a lot of
19 their gripes and complaints, we could also set a
20 minimum threshold of \$20,000 per transaction or
21 \$50,000.

22 I guess I'm not to the point that I'm
23 convinced that they have a legitimate gripe, but
24 rather than throw out the entire rules because of
25 burdensome, the backup position would be to have some

1 minimum threshold.

2 Q. Okay. On Page 14 of the reply comments, the
3 last sentence of the last full paragraph,
4 "Furthermore, Public Counsel notes that a detriment
5 would clearly exist when the utility provides
6 resources to its affiliate at an incremental cost when
7 these same resources could have been sold to a
8 nonaffiliated entity at a higher market price."

9 My question is, if you start with market
10 price and allow flexibility when market price is
11 unavailable, why wouldn't that overcome your
12 objection?

13 A. Can I just read the whole paragraph, and
14 then, perhaps, you can repeat that question?

15 Q. Sure.

16 A. Okay. Now, if I could have you repeat the
17 question?

18 Q. I think it has been suggested that the
19 starting point should be market price when market
20 price is available, and when it's not, there should be
21 flexibility allowed to determine the appropriate
22 costing methodology. And if you -- if you begin with
23 market price which you allow that flexibility, why --
24 would that overcome that objection that you're stating
25 there?

1 A. As I read this -- this last sentence to the
2 paragraph, all the Public Counsel was saying was that,
3 you know, the utility shouldn't sell a limited good or
4 service to its affiliate at an incremental cost when
5 it could extract a market price from a nonaffiliate.

6 Q. And what I'm saying is, if you begin with
7 market price, if market price is available, then,
8 that's what the -- the utility should sell it to its
9 affiliate for?

10 A. Yeah, they should, unless for some strange
11 reason the fully distributed cost is above market. I
12 would expect that to be a rare occasion, but it could
13 happen. Yeah, you would start with fair market value
14 and market price.

15 Q. On Page 30 of the reply comments, about the
16 middle of the page there, beginning of the paragraph,
17 "The OPC would agree that each utility could expend
18 fairly significant resources in the first edition of
19 its CAM." I want to ask you, in relation to the
20 resources that a utility could spend, have you at all
21 given any consideration to the fiscal note that was
22 presented with this rule?

23 A. The quick answer is no. I do remember
24 reading some comments to that effect, but I haven't
25 dwelt on it.

1 Q. Okay. But it would be your opinion that the
2 cost could be fairly significant in the first -- first
3 year?

4 A. The first time around I think could be, yes.

5 Q. And you mentioned earlier in your comments
6 that the GSA is probably consistent with fully
7 distributed costs. The SEC rules use fully
8 distributed costs, do they not?

9 A. The SEC rules don't -- my read on the SEC
10 rules, they don't specifically use the word "fully
11 distributed costs," but they talk about a fair
12 allocation of overhead costs. They don't seem to
13 be -- I mean, they seem to be consistent, but my
14 read -- I did not see in the SEC rules where they
15 specifically used the term "fully distributed costs."

16 Q. And what was the phrase you just said they
17 used?

18 A. I think it's in the comments. I think it's
19 on Page 26.

20 Q. Of the reply comments?

21 A. Of the reply comments, yeah. At the bottom
22 of Page 26 is the exact language from the costing
23 standard found at 17 CFR.

24 In there they talk about, a transaction will
25 be deemed to be performed at not more than cost if the

1 price, taking into account all charges, which is
2 basically FDC, does not exceed a fair and equitable
3 allocation of expenses." And the next paragraph talks
4 about elements of cost including taxes, other
5 overhead, et cetera, et cetera.

6 So it would seem that they are consistent.

7 Q. By referencing allocation of expenses, you
8 are equating that to fully distributed costs?

9 A. Yes.

10 COMMISSIONER MURRAY: Okay. I think that's
11 all of my questions. Thank you.

12 JUDGE THORNBURG: Commissioner Schemenauer?

13 COMMISSIONER SCHEMENAUER: I have no
14 questions.

15 JUDGE THORNBURG: Any follow-up questions?

16 (No response.)

17 JUDGE THORNBURG: Thank you, Mr. Dittmer.

18 There may be some other questions later, but
19 you are excused at this time.

20 (Witness excused.)

21 JUDGE THORNBURG: Mr. Coffman, do you have
22 an additional witness?

23 MR. COFFMAN: Yes. Our next and final
24 witness or commenter will be Ryan Kind.

25 (Witness sworn.)

1 JUDGE THORNBURG: Thank you.

2 You may be seated.

3 Again, I will ask that you reintroduce
4 yourself briefly, and we'll take your prepared
5 comments and then ask questions.

6 MR. KIND: Okay. My name is Ryan Kind, and
7 I'm the chief energy economist for the Missouri Office
8 of the Public Counsel. I've been employed at the
9 Office of Public Counsel for a little over eight years
10 and have been involved in various types of rate cases,
11 merger cases, and have been involved extensively in
12 class cost of service cases also.

13 The prepared comments I'd like to present is
14 I just wanted to first start off by stating that I
15 played a major role in the drafting of OPC's comments
16 and the proposed rule, and I'm ready to answer any
17 questions that the Commissioners may have.

18 As our attorney, Mr. Coffman, noted, James
19 Dittmer took the lead role in writing the comments on
20 the pricing rules, and so, hopefully, he's addressed
21 most of the Commission questions on that topic. But I
22 certainly am here to answer any questions that the
23 Commissioners might have.

24 Before moving on to answering questions
25 regarding our comments, I'd like to speak a little bit

1 about recent trends in utility operations that have
2 led to the need for affiliate rules in Missouri. And,
3 also, I want to discuss some of the information
4 regarding affiliate activities that Public Counsel has
5 scrutinized in this case and in other recent
6 Commission cases.

7 First, on the subject of recent trends in
8 utility operations, most Missouri energy utilities are
9 operating in a vastly different manner when -- than
10 they were when I first started working at the Public
11 Counsel's Office in that at that time they were
12 engaged primarily in regulated operations with just
13 very limited experimentation at that time in some
14 nonregulated areas.

15 Nonregulated areas now constitute a
16 significant part of the operations of Missouri
17 utilities and continue to grow. As Ms. Shemwell
18 stated earlier today, you don't really have to do a
19 thorough audit or examination of Missouri utilities to
20 notice this trend. A simple examination of Missouri
21 investor-owned utility reports to shareholders is --
22 is sufficient to see the changes that have been
23 occurring in recent years.

24 In fact, as I was writing my comments last
25 night, preparing them and making the same point that

1 Ms. Shemwell read -- made earlier regarding the
2 reports to shareholders, I -- about 20 minutes after I
3 finished writing these comments I was looking through
4 the Wall Street Journal and out popped at me an ad for
5 Ameren stating that business customers can count on
6 Ameren now for more than just electricity, gas, for
7 instance. And some of the text of the ad says, "The
8 combination of AmerenUE," and I noted -- it's sort of
9 significant, I think, to note that they actually are
10 leveraging Union Electric's brand name here by stating
11 "AmerenUE," not just Ameren.

12 Back to the direct quote: "The combination
13 of AmerenUE and Ameren Energy makes us uniquely
14 qualified to become your company's total energy
15 provider. That means you can count on us for
16 electricity and natural gas and much more like energy
17 management products, gas and electric, efficiency
18 audits, and a full range of additional products and
19 services to help your company get the most out of the
20 energy that we provide." And, again, this was in
21 yesterday's Wall Street Journal.

22 Some additional information that the
23 Commission might be interested in that illustrates the
24 recent trends in diversification would be some of the
25 information that Public Counsel obtained through

1 discovery in this case. I'm going to go over some of
2 that information in general a little bit later, but
3 some of the information that's more on -- on point
4 specific to this question is one of the questions we
5 asked is that we asked for organizational charts for
6 all of the five investor-owned utilities that show the
7 relationships between the companies and their
8 affiliated entities. And those answers are fairly
9 voluminous. Some of them are confidential. If the
10 Commission did want to see this information, we -- you
11 know, it would have to be labeled confidential.

12 But, needless to say, while I was aware of
13 extensive diversification, I guess, from looking at
14 this information, there is really even greater
15 diversification than I really had imagined.

16 Then I wanted to discuss some of the other
17 information that my office received through discovery
18 in this case regarding affiliate transactions and just
19 some -- I think, some good background information that
20 would be helpful for the Commission when they look
21 just to be able to see some of the current utility
22 practices, for example, in terms of the extent to
23 which utilities are using their monthly bill to
24 promote nonregulated products and to bill customers
25 for nonregulated products.

1 And I've -- I've prepared a summary of this
2 information. It's been -- where there is some
3 information that might get into confidential areas,
4 it's just summarized in very vague terms, not talking
5 about, really, specific contracts with specific
6 customers and things like that. But I think that John
7 Coffman has additional copies of this, if the
8 Commission would be interested in looking at it as I
9 go over it.

10 And I would just note while he's passing
11 that out that we -- the discovery that we sent out to
12 electric utilities was largely just asking the same
13 questions to each utility just to get a general gauge
14 of some of the practices that are occurring. And I
15 haven't labeled this to the extent of labeling
16 specific DR questions or anything, but they are just
17 basically summarizing some of the questions that were
18 asked and the responses and there are responses by
19 utility and then sort of a summary of some of those
20 responses where appropriate.

21 First of all, the first line there, it shows
22 the extent to which utilities have used the monthly
23 utility bills to bill for unregulated products, and as
24 you can see, two out of five Missouri investor-owned
25 utilities have done that.

1 The second line shows the extent to which
2 utilities have used their monthly utility bill to
3 promote unregulated products. As you can see, three
4 out of five have done that.

5 The third one is the utilities that have
6 made their customer list or customer-specific
7 information available to unregulated operations. And,
8 as you can see, nearly all of our utilities have
9 passed on that highly valuable to their unregulated
10 operations.

11 The next question regards utilities that
12 solicit business or make leads available to their
13 unregulated operations, and that's four utilities.

14 COMMISSIONER CRUMPTON: Yes, I have a
15 question.

16 Just looking at the questions and the
17 responses, suppose the companies that have responded
18 "yes," for example, on the first item that use monthly
19 utility bills to bill for unregulated products,
20 suppose they made that service available to their --
21 to the other providers of services who probably would
22 be competitors to their affiliates? I mean, what
23 would be wrong with making a service available to
24 anyone who's willing to pay?

25 MR. KIND: I generally don't think there

1 would be any problem with that. I don't think that
2 has ever occurred in Missouri.

3 COMMISSIONER CRUMPTON: Okay.

4 MR. KIND: But, really, what you're getting
5 at there is, if -- if they can make the service
6 available to their affiliates and they can charge
7 their affiliates something for it, that's -- to some
8 extent, that's taking advantage of economies of scale
9 and scope, and if they make it available to their
10 affiliate's competitors or others, that's even further
11 taking advantage of their economies of scale and scope
12 in a manner that can benefit ratepayers by having
13 some -- some revenues from these unregulated services
14 to offset the costs of these systems that have been
15 built to provide for regulated services.

16 COMMISSIONER CRUMPTON: Okay. Thank you.

17 JUDGE THORNBURG: Proceed.

18 MR. KIND: I think the -- I was on the one
19 about soliciting business, and I noted there were four
20 responses there. An example of that might just be
21 somebody goes out to visit a customer to speak with
22 them about maybe some problems that they're having
23 with their service line or just their meter or
24 something, and while they are there, they also tell
25 the customer, well, we -- you know, are you interested

1 in energy conservation services, or something like
2 that.

3 And that's something that would be a little
4 more difficult to do in the manner that you just
5 described, Commissioner Crumpton, in terms of, you
6 know, allowing -- I don't think they would go out with
7 a whole gang of people and say, Here is our energy
8 conservation specialist, and here is one for Enron,
9 and on down the line.

10 And then the -- I guess this is the sixth --
11 or the fifth sort of general question. The utilities
12 that are currently promoting unregulated products and
13 services to new utility customers, there is two of
14 those. And the way that generally would occur is that
15 you sign up a new customer and they go into the office
16 and you distribute some -- give some -- the customers
17 some information there about your unregulated
18 operations, or maybe you just send the customers --
19 the new customer an information booklet in the mail
20 that contains some of that information.

21 The next -- the next three items here are
22 just sort of some really general summaries of the
23 extent to which -- they show the extent to which
24 utilities are diversifying into unregulated areas and
25 the extent to which there are transactions taking

1 place between the regulated utility and their
2 nonregulated affiliate.

3 And the first one talks about partnerships,
4 joint ventures, strategic alliances, joint marketing
5 agreements, and as you can see, some of that is taking
6 place. That is an example of one where we just really
7 haven't -- haven't pinned down all of the utility
8 responses.

9 If I've got a question mark there or a
10 nonresponsive response, I don't mean to imply that our
11 utilities have really purposefully not fully
12 responded. It's more likely that it's a matter that I
13 just didn't have time to follow up and figure out how
14 to interpret their response or to clarify that you
15 provided this information to me, but this is really
16 what I was looking for.

17 Then the bottom two, the second-from-the-
18 last is just a general characterization of the
19 quantity of affiliate transactions taking place
20 between the regulated utility and affiliated entities
21 and our five investor-owned electric utilities.

22 As you can see, except for St. Joseph
23 Light & Power that just had some limited transactions
24 taking place, there were just very numerous high-level
25 affiliated transactions taking place at all of the

1 other utilities.

2 The last one, I'm not sure if I really
3 labeled this clearly. It says, "Top 30 customers
4 agreements for nonregulated products." What I'm
5 getting at there is that these are agreements that the
6 utilities' nonregulated affiliates have to provide
7 products to the regulated utilities' largest top 30
8 customers.

9 And it's something that I think can be
10 troublesome and can be a place where there is some
11 unfair preference shown in that you have generally --
12 for example, almost all of our utilities have a key
13 accounts department where they provide special
14 services to their largest customers. These key
15 account representatives really develop a relationship
16 with the largest customers, and sometimes they --
17 therefore, they will have some unique relationships
18 with these customers that the utility's competitors
19 would not have. And so I think it's something that
20 deserves further scrutiny, the amount of these types
21 of, you know, sales and contracts that are taking
22 place in this area.

23 And I would be glad to answer any further
24 questions about that now or at the conclusion of my
25 remarks.

1 JUDGE THORNBURG: Okay. Commissioner
2 Drainer, do you have any questions at this point?
3 COMMISSIONER DRAINER: No. I would just
4 have him finish his remarks.
5 JUDGE THORNBURG: Do you have a question,
6 Commissioner Crumpton?
7 QUESTIONS BY COMMISSIONER CRUMPTON:
8 Q. On the St. Joseph company where the table
9 shows a majority of nos --
10 A. They are unique in that respect, yes.
11 Q. But I want to -- I guess the nos are
12 reflected in your next-to-the-last response, which is
13 some, which implies that they probably have very few
14 affiliate transaction activities in that company as
15 compared to, say, for instance, UE or Utilicorp?
16 A. That's correct, fewer transactions, and they
17 just sell fewer -- their nonregulated affiliates just
18 sell fewer products and services. And it just makes
19 sense that a smaller company would not have had the
20 resources to move into those different areas that some
21 of the larger companies would.
22 Q. You mentioned the fact that many of the
23 energy companies are diversifying and thereby entering
24 into many unregulated areas. I see this as a concern
25 when we're having a rate case, and the companies will

1 have their departments or affiliates intermingled in
2 the same building or on the same floor even, and they
3 go to try and allocate costs between the regulated
4 company and the affiliates and great conflict arises
5 because it seems that their record-keeping is
6 difficult -- it makes it difficult for Commissioners
7 to understand the separations between the entities.

8 And I recall when the Bell system was broken
9 up, and the telephone company -- I happened to work
10 for Southwestern Bell at the time. We had to paint
11 stripes along the floor to show where -- when we were
12 in the toll buildings where this is AT&T's side and
13 this is Southwestern Bell's side.

14 And so we had to be careful. And some of us
15 were imagining walking down that hall, as an example,
16 and not stepping over on the AT&T side of the line.

17 And -- but now as a Commissioner I'm dealing
18 now with an issue where I don't see those lines on the
19 floor. And these corporations have become so complex
20 that for a Commissioner, you're almost imagining
21 looking into a big gray cloud. And the companies are
22 trying to tell you, well, this is where the separation
23 is and this is where the separation is, and it's --
24 it's very difficult without records for us to tell
25 where those separations are.

1 So I appreciate the comments of the Office
2 of Public Counsel and just want you to know that.

3 A. If I could follow up on that, the -- we've
4 noted the same difficulty, of course, in rate cases
5 and when our accountants are out doing audits, and a
6 lot of times the information is just not preserved in
7 order to determine whether or not there has been any
8 harm to ratepayers.

9 And this -- the Commission's proposed rule
10 in this case, I think, really goes a good distance to
11 recognizing that problem, particularly in terms of the
12 record-keeping requirements. We'll have the
13 information available in rate cases. But we -- the
14 Public Counsel's Office really feels like that that
15 is -- is just not going quite far enough and that
16 there is still a tremendous amount of complexity
17 involved, even if you have the record-keeping.

18 And it's just difficult to keep the records.
19 For example, we have some companies that have
20 regulated and unregulated operations within one
21 corporate entity. And so, traditionally, you are not
22 tracking those kinds of transactions within one
23 corporate entity. There aren't any bookkeeping
24 transactions that would be made for tax purposes or
25 accounting purposes or anything else.

1 This rule would require those sort of
2 transactions to be tracked for the specific purpose of
3 compliance with this rule. As I was stating, we've
4 gone a further step, though, in our suggestion for a
5 provision that we've titled the sec-- where the
6 section is titled "Independent Functioning."

7 Q. What page is that?

8 A. It's on -- you can find it in our initial
9 comments, and it's in -- it's in one of our
10 attachments. It's Attachment 1, Page 4.

11 What we're proposing there is that the
12 Commission not allow a mixture of nonregulated and
13 regulated operations to take place within one
14 corporate entity, and that's what this provision would
15 do.

16 Q. Well, to carry that a little further, if the
17 corporate entity has a mixture on the same -- in the
18 same building or on the same floor --

19 A. Well -- and this provision actually
20 addresses that, too, was that Subpoint 3, sharing of
21 plant facilities, equipment or costs, because you
22 could have a separate corporate entity -- two
23 corporate entities, I think what you're suggesting,
24 with facilities on the same floor, and what we're
25 suggesting is that a requirement for sort of the --

1 you know, the bright-line-on-the-floor-type of thing
2 that you were discussing.

3 And the rule -- that type of requirement has
4 actually already been put in place, for example, by
5 the Federal Energy Regulatory Commission for electric
6 utilities that are involved in wholesale power
7 transactions, that when they have a -- when they set
8 up an operation to sell -- to be a power marketer,
9 that's distinct from their -- from their marketing
10 operation that they do for the purpose of the
11 regulated utility. There has to be a -- some
12 separation of the employees in that power marketing
13 unit from the other employees at the utility.

14 So, for example, the utility has a lot of
15 information about, you know, which -- just through
16 things like the scheduling of transactions for -- in
17 order to utilize their transmission system. The
18 regulated utility gains knowledge of which competitive
19 businesses out there are actually providing power
20 within their service territory, for example, to a city
21 that might be a wholesale customers that's not served
22 by the regulated utility.

23 And so the FERC has put in place rules that
24 would address that so that the regulated utility would
25 not have an advantage in gaining this market knowledge

1 about market participants that no one else would have.

2 But, of course, those FERC rules just apply
3 strictly to wholesale power operations. And so what
4 we're suggesting here is a more comprehensive rule
5 that would apply to not just wholesale power
6 regulations but all of their other nonregulated
7 operations.

8 Q. But this would apply in the event that we
9 bifurcated the electric industry separating
10 marketing from -- the marketing of electricity from
11 the maintenance of the plant itself, would it not?

12 A. Right. It definitely is something that
13 becomes even more necessary in that type of situation.
14 Of course, there's already plenty of transactions
15 taking place prior to restructuring the energy
16 industry in Missouri, but that's usually part of --
17 taking another -- a second look at things is often
18 part of the restructuring process because there is
19 just other specific things that you have to deal with,
20 power -- the utility having its own power marketer,
21 not just engaging in wholesale transactions, but then
22 they have a power marketer that's also engaging in
23 retail transactions within the state that you have to
24 be concerned about it.

25 MR. KIND: If I could return to my comments,

1 I think I just have one last area that I wanted to
2 discuss, and that is just some additional information
3 that I wanted to be available to answer any questions
4 from Commissioners if they want to hear any details
5 about the experience my office has had in auditing
6 specific affiliate transactions in Missouri.

7 And I note that in our -- in our initial
8 comments we have a Section 3 that described in some
9 very general terms some examples of utility behavior
10 in Missouri that we believed clearly illustrated the
11 need for a nonaffiliate rule in Missouri.

12 And our initial comments also included a
13 Section 4 that provided some details about utility
14 behavior. This information that was provided in
15 Section 4 was voluntarily withdrawn by our office from
16 our initial comments due to problems in the procedures
17 that were used to obtain some of this highly
18 confidential information.

19 However, since that time, these problems
20 have been rectified, and I'd be glad to answer
21 Commissioner questions regarding the details of some
22 of OPC's findings regarding the following examples of
23 what we believe are some potentially harmful utility
24 behavior.

25 And I'm going to just cite these examples in

1 very general terms without naming any utility names
2 because it is confidential information. But our
3 activities -- and, again, I should -- before I even
4 talk about these examples, I want to really emphasize
5 that we really have not done a comprehensive audit of
6 what's going on in affiliate activities in Missouri.
7 We have primarily come across just some examples of
8 certain behavior that we think are detrimental to
9 regulated ratepayers through the process of other
10 cases, rate cases and merger cases and things like
11 that.

12 And a couple of the examples that we've come
13 across are that we've seen a utility allow its
14 affiliate to use some very valuable assets of the
15 utility for no compensation whatsoever.

16 We have seen a utility that negotiated a
17 package of regulated and nonregulated services with
18 one of its largest customers where the offers for some
19 of these services were contingent upon taking other
20 services. And if I were to say anything more about
21 this, we would have to go in camera, so I'm leaving
22 that up to the Commission.

23 And that's -- that really is the -- that
24 concludes my comments. And now I will be glad to
25 answer any questions.

1 JUDGE THORNBURG: Commissioner Drainer?
2 COMMISSIONER DRAINER: I have no questions.
3 Thank you.
4 JUDGE THORNBURG: Okay. Commissioner
5 Crumpton?
6 COMMISSIONER CRUMPTON: How long would it
7 take us to remain in camera for you to cover this
8 material?
9 MR. KIND: I would think that just 20
10 minutes would probably be more than sufficient.
11 COMMISSIONER CRUMPTON: Twenty minutes would
12 carry us through lunch.
13 JUDGE THORNBURG: Yeah. I'm not sure about
14 the procedure to do that in rulemaking.
15 COMMISSIONER CRUMPTON: We have an
16 obligation to protect their proprietary information --
17 JUDGE THORNBURG: I think we do.
18 COMMISSIONER CRUMPTON: -- the Company's and
19 the customers.
20 JUDGE THORNBURG: We'll take a short break.
21 Off the record, please.
22 (A discussion was held off the record.)
23 JUDGE THORNBURG: We'll go back on the
24 record.
25 Were there any additional questions,

1 Commissioner Drainer?

2 COMMISSIONER DRAINER: No, I have no
3 additional questions.

4 JUDGE THORNBURG: Commissioner Crumpton?

5 COMMISSIONER CRUMPTON: I have no questions.

6 JUDGE THORNBURG: Commissioner Murray?

7 COMMISSIONER MURRAY: I have two or three.
8 Thank you.

9 QUESTIONS BY COMMISSIONER MURRAY:

10 Q. Good morning.

11 A. Good morning.

12 Q. If we were to adopt your suggestion of
13 completely separate corporate entities, why would we
14 need all of these reporting requirements and the
15 extensive rules as they are written?

16 A. Well, the first example that comes to mind
17 is that while we encourage that particular mode of
18 regulation because there will be a requirement just to
19 track the transactions that take place for, you know,
20 tax reporting purposes and things like that, and there
21 will be more information available, without any
22 regulation, there would be no requirement, for
23 example, for each transaction that takes place for the
24 utility to determine the fair market value of that
25 transaction. There would just be -- the utility would

1 record some amount for the transaction.

2 There would be a record -- you know, it
3 would be more likely that there was a record that the
4 transaction took place than there is now under current
5 organizational form, but there wouldn't be the
6 information available to decide in a rate case whether
7 transactions took place at the appropriate price, and
8 it wouldn't require necessarily the preservation of
9 all of the information to do fully distributed costing
10 as well.

11 Q. I was going to say, why wouldn't it just be
12 sufficient to say that the utility could not
13 discriminate and could not provide its affiliate with
14 any advantage over any of the affiliate's competitors?

15 A. Well, that kind of leaves us in the
16 situation we are today where the -- I mean, it would
17 be a little bit different in that there would be a
18 mandate from the Commission that certain behavior
19 should not take place, but there is still -- it would
20 be very difficult for an auditor to determine whether
21 or not any inappropriate behavior took place unless
22 there is a record of the transaction taking place.

23 Q. Even if it were two separate entities?

24 A. Yes, because, as I mentioned, that would not
25 necessarily preserve the information necessary to do

1 all of the cost allocations for fully distributed
2 costing, and it wouldn't preserve -- it wouldn't
3 require them to determine and record at the time the
4 transaction took place the fair market value of the
5 transaction.

6 Q. Okay. So separating the entities really
7 wouldn't simplify anything, is what you're saying?

8 A. No, I'm not saying that. It makes sure
9 that -- there is really -- there's two things taking
10 place here. There's the standards for the financial
11 standard and there is the no preference standard.

12 And it would simplify things for
13 implementing the financial standard in that
14 transactions could not take place without even being
15 recorded, which is the situation when you don't have a
16 separate corporate entity. The transactions would
17 have to be recorded, but the fact that the transaction
18 was recorded wouldn't mean that the information is
19 available to determine whether or not it was priced in
20 a manner that was detrimental to ratepayers.

21 And then the no preference standard is
22 something that really -- it would be -- it would be
23 facilitated by -- also by corporate separation in that
24 you could be assured that the nonregulated affiliates
25 of the company would not have access -- wouldn't be

1 intermingling with the regulated utility employees,
2 for example, and sharing information.

3 And you also would not then have a situation
4 where you would have an employee who worked for both
5 regulated and nonregulated operations and through that
6 type of relationship was able to gain information on
7 the regulated side, put it to use in the unregulated
8 side.

9 Q. Okay. In general, I'd like to ask you if
10 you think that affiliate transactions on their face
11 are harmful to the ratepayers?

12 A. No. There is -- I think that there is sort
13 of two questions, maybe, and I'm -- you asked one, but
14 to me there is, like, is the fact that a transaction
15 took place harmful?

16 And, no. You have to look at the details of
17 it to determine if it's harmful.

18 Q. Could it be beneficial to the ratepayers?

19 A. I'm assuming you are sort of speaking in
20 terms of, like, spreading out costs to a larger number
21 of operations to both the regulated and nonregulated
22 operations?

23 Q. Yes.

24 A. In that sense, it could be beneficial.

25 It could be further beneficial if there is

1 this sort of no preference requirement where you've
2 got some valuable utility assets that could be used by
3 the nonregulated entity that could also be used by the
4 competitors of the nonregulated entity. Then that
5 sort of provision, you could even have a greater
6 benefit, you know, in terms of sharing -- spreading
7 costs from those different operations.

8 Q. So it would not be your purpose in the
9 rulemaking to prevent affiliate transactions from
10 occurring?

11 A. No, definitely not. I know some of the
12 utilities have argued that the kind of proposals that
13 have been made by Public Counsel would likely lead to
14 the succession of nonregulated activities. And,
15 frankly, there are similar rules in place in other
16 states, and I've never heard that this has caused
17 affiliated transactions to slow down or come to a
18 halt.

19 Q. Do you think that in some instances it may
20 cause those that are beneficial to ratepayers to be
21 less frequent?

22 A. I think that would -- that would partly
23 maybe depend on the way in which the rule is
24 implemented. There is -- and the different players
25 that are involved. Of course, the Commission would be

1 a very important player. The Commission Staff and
2 Public Counsel would both be important players.

3 And my office would not intend to try and
4 raise any complaints about, for instance, variances
5 from utility transactions where a company can come in
6 and show that without a variance, the ratepayers are
7 harmed. We welcome those kind of variances to ensure
8 that ratepayers can get the maximum benefit from
9 affiliated transactions.

10 Q. Okay. I'd like to look at your exhibit that
11 you just handed us a little while ago.

12 A. Sure.

13 Q. The Data Request Response Summary. In the
14 first item where utilities have used monthly utility
15 bills for unregulated products, how does that harm the
16 ratepayers?

17 A. Well, first of all, of course, you have to
18 look and see that you get the kind of information
19 recorded from the financial standard point of view to
20 make sure that you are using the higher of fully
21 distributed or fair market value.

22 Q. I'm just asking you, on its face, if we just
23 looked at your facts here --

24 A. Okay.

25 Q. -- are we supposed to assume that from an

1 answer of "yes" to one of these questions that that's
2 automatically bad, or --

3 A. No, no.

4 Q. Okay. We can assume that even those
5 utilities who answered "yes" to this are not
6 necessarily doing anything that's harmful to the
7 ratepayers; is that correct?

8 A. Well --

9 Q. Not necessarily doing anything harmful to
10 the ratepayers?

11 A. Right. For instance, you know, Commissioner
12 Crumpton asked a question about have other -- have the
13 affiliates' competitors been allowed, you know, the
14 same privileges? And to the -- that would be really
15 the main reason, I think, that I would qualify my
16 response, is that with -- I have not collected that
17 information, but I'm not aware of whether that's been
18 allowed to occur. And if that's not allowed to occur,
19 then the public can be harmed by having the utility
20 have a great advantage in some unregulated markets.

21 Q. My question to you, Mr. Kind, is, from the
22 document that we have before us and the questions that
23 OPC asked and the answers that OPC received, we cannot
24 assume from any of those answers -- we cannot surmise
25 from any of those answers that there was or was not

1 harm to the ratepayers, can we?

2 A. I think you're saying from this information
3 alone?

4 Q. From the information alone.

5 A. And I think I would agree with you.

6 COMMISSIONER MURRAY: Okay. Thank you.

7 I think that's all of my questions.

8 JUDGE THORNBURG: Commissioner Schemenauer?

9 COMMISSIONER SCHEMENAUER: No questions.

10 JUDGE THORNBURG: Mr. Coffman, do you have
11 any other witnesses?

12 MR. COFFMAN: No. That is it.

13 JUDGE THORNBURG: Okay. On this exhibit
14 that's been talked about today, would you like to have
15 that added to the record as a supplement?

16 MR. COFFMAN: That's up to the Commission.
17 I understand it's not an evidentiary proceeding.

18 JUDGE THORNBURG: Well, we can take exhibits
19 in a rulemaking, and I'm afraid the record would be
20 incomplete if we don't have that to reference to.

21 Do you have a clean copy of that?

22 MR. COFFMAN: I have one more clean copy.
23 Apparently, I didn't make enough clean copies.

24 JUDGE THORNBURG: I've got extra copies
25 here.

1 MR. COFFMAN: I have a couple.

2 It would be fine if that would be attached
3 to the transcript. It might be easier for those
4 reading it.

5 JUDGE THORNBURG: If the court reporter
6 would, we'd like to have that attached as an exhibit
7 to Mr. Kind's testimony.

8 (EXHIBIT NO. 1 WAS MARKED FOR
9 IDENTIFICATION.)

10 JUDGE THORNBURG: Commissioner Drainer had
11 something to address to the bar here today.

12 COMMISSIONER DRAINER: Yes. I just -- I
13 wanted to ask two quick questions of the attorneys for
14 the regulated utilities that are here for us today so
15 that after the other witnesses make their remarks and
16 we go do a round on the attorneys, I thought I would,
17 as a courtesy, ask the question of you now and give
18 you a chance over lunch to see whether or not you care
19 to answer. And it's your choice. And it's just to
20 make this record as clear as yesterday's record was.

21 And my two questions are, one, I would like
22 to ask the attorneys if they have any comments to make
23 with respect of what the cost of implementing this
24 rule would be to their company. We have an estimate
25 in this proposed rule of 100,000 for the first year

1 and, I think, 75,000 for the second year. So I would
2 appreciate a comment both today and tomorrow, of
3 course, for anybody that might be sitting in the back
4 of the room that might be talking to us tomorrow.

5 And the second question is if you care to
6 respond with respect, this afternoon, to --
7 Paragraph 9 is on the variance, and yesterday I asked
8 if it would be reasonable, and should the Commission
9 make clear, that on a company-by-company basis, not
10 transaction-by-transaction, but on a company-by-
11 company basis a company could come in and ask for a
12 variance from all or part of the rule with their
13 justification of why they need that, and is that a
14 more reasonable approach to take, or should we make
15 that clear?

16 Now, if I haven't made this part clear, what
17 I said when I talked to Mr. Duffy, I think he finally
18 understood what I was asking yesterday.

19 COMMISSIONER CRUMPTON: Can you explain it
20 to us?

21 COMMISSIONER DRAINER: But if anyone has any
22 questions about that, I would be happy to answer it
23 this afternoon when we do a round. But I wanted to
24 give you the opportunity to think about that over
25 lunch. Thank you.

1 JUDGE THORNBURG: Mr. Coffman, you didn't
2 want the testimony of these two witnesses incorporated
3 in the other records?
4 MR. COFFMAN: Yes, I would.
5 JUDGE THORNBURG: And I'll ask the court
6 reporter that the testimony today of Mr. Kind and
7 Mr. Dittmer be reproduced for Case No. HX-99-443 and
8 GX-99-444 and GX-99-445.
9 We will reconvene at 1:15, after a lunch
10 break. Thank you.
11 (A recess was taken.)
12 JUDGE THORNBURG: We'll go back on the
13 record.
14 I've got just a couple of things to real
15 quickly clean up our record.
16 The Commission doesn't have any further
17 questions at this time for Mr. Kind.
18 Yes?
19 MR. COFFMAN: Before you go any further, if
20 I might, we were wondering, since the Commission is
21 now incorporating comments from one of these hearings
22 into the other rulemaking hearing, if it might be
23 possible for Mr. Dittmer to be excused, I guess, with
24 regard to tomorrow's hearing. Unless the Commission
25 had any natural gas-specific questions, we might no

1 longer need him.

2 JUDGE THORNBURG: I'm going to leave --

3 unless the Commissioner has a comment on that, I'll

4 leave that up to you, to your discretion. If the

5 Commission comes up and he's not here, we won't be

6 able to address that.

7 MR. COFFMAN: As far as I know his comments

8 are equally applicable today as to natural gas.

9 JUDGE THORNBURG: Something else just to

10 speed this along today. Enough witnesses and

11 commenters have asked today's comments be incorporated

12 that I'm just going to direct the court reporter to

13 mark today's transcript as Exhibit A, and it will be

14 attached in the records for the HX-99-443 and the

15 GX-99-444 and GX-99-445 cases. That way we won't

16 leave anything out, and they will all be together.

17 MR. COFFMAN: 442?

18 JUDGE THORNBURG: HX-99-442 (sic). Thank

19 you.

20 Sorry. I misspoke myself.

21 MR. COFFMAN: This is 442. I believe the --

22 JUDGE THORNBURG: The electric is 442 -- let

23 me get my notes out, now that we've made it real

24 unclear.

25 The electric case is EX-99-442, and that's

1 what we're in today. This record will be attached to
2 the record for the heating affiliate, which is 99--
3 HX-99-443, and the two gas rulemaking proposals
4 GX-99-444 and GX-99-445. Okay.

5 And Mr. Kind's chart that he had as an aid
6 to his testimony has been marked as Exhibit 1. And
7 that's going to be part of this record.

8 Mr. Duffy had some comments to address to
9 that so I'm going to ask him to go ahead and make his
10 comments now.

11 MR. DUFFY: Your Honor, I'll be real brief.

12 I just want to clarify that our objection to
13 the sworn testimony taken would apply also to, in
14 particular, the document that you have just indicated
15 as marked as Exhibit 1. Our objection would be to any
16 kind of documents coming in that are referred to in
17 the sworn testimony by these people. So I didn't
18 want anybody to misunderstand that our objection was
19 only to the sworn testimony, but that it also apply
20 to any documents that might be produced as an
21 exhibit.

22 And very briefly I wanted to maybe clear up
23 a potential misunderstanding in my response to
24 Commissioner Murray's question when she asked me if
25 you didn't swear the witnesses would that take care of

1 the objection. Well, that would take care of that
2 part of the objection. We still, of course, had the
3 objection to the lack of contested case procedures in
4 this entire proceedings.

5 So I didn't want anybody to misunderstand
6 that by simply not swearing witnesses that that
7 somehow made all of our objections go away.

8 That's all I wanted to say.

9 JUDGE THORNBURG: Thank you.

10 Commissioner Crumpton?

11 COMMISSIONER CRUMPTON: I have a question.

12 Mr. Duffy, has the Commission ever used
13 contested case procedures in a rulemaking?

14 MR. DUFFY: It's my understanding that they
15 at least allowed cross-examination several years ago
16 in the proceeding involving the chapter -- the initial
17 establishment of what was the Chapter 13 billing
18 practicing rules. I can't -- I wouldn't swear that
19 that's accurate, but that's my best understanding,
20 that it did occur. And --

21 COMMISSIONER CRUMPTON: Is there any reason
22 why you waited until this proceeding to challenge the
23 procedures that the Commission is using?

24 MR. DUFFY: Well, in this proceeding, the
25 Commission cited a particular statute that they said

1 give them authority to promulgate these rules. That
2 statute says you have to have a hearing at which
3 evidence as to the reasonableness of the rules has to
4 be taken. And so our objection is not that the
5 Commission has to in every rulemaking have contested
6 case procedures, but we think in this one, because of
7 the wording of that statute, the statute requires you
8 to do that.

9 COMMISSIONER CRUMPTON: Well, the statute --
10 is it a brand new statute, or is it one that's been
11 around for a while?

12 MR. DUFFY: It's been around for a while.

13 COMMISSIONER CRUMPTON: Well, my question
14 is, why -- I mean, your firm has read those statutes
15 in the past and has participated in rulemakings since
16 I've been here on a number of occasions, and I'm just
17 wondering why you waited until now to challenge the
18 process. It seems to me that if there was something
19 wrong with it, you would have recognized it a long
20 time ago and challenged it a long time ago.

21 MR. DUFFY: Well, the other way to look at
22 it is, this is the first instance in which that
23 statute has been applicable, and I would say that's
24 what's going on here, that it hasn't been a problem in
25 the past.

1 COMMISSIONER CRUMPTON: Okay. Thank you.
2 JUDGE THORNBURG: Thank you, Mr. Duffy.
3 We're going to try to work through the
4 proponents today before we take up the opposing
5 comments.
6 COMMISSIONER CRUMPTON: Judge?
7 JUDGE THORNBURG: Yes.
8 COMMISSIONER CRUMPTON: I did have a
9 question or statement to make on Mr. Kind's offer to
10 do the in camera presentation for us. That is no
11 longer required. But I did have questions for him on
12 the transfer of employees.
13 JUDGE THORNBURG: Then we can address that
14 now.
15 Mr. Kind, you are still under oath.
16 If this isn't going to be too lengthy, we
17 don't need to have him come up to the Bench.
18 COMMISSIONER CRUMPTON: Well, I don't know.
19 JUDGE THORNBURG: Okay. Why don't you come
20 back up to the stand?
21 COMMISSIONER CRUMPTON: It depends on how
22 much he wants to elaborate.
23 MR. KIND: Should I have a copy of OPC's
24 proposal with me?
25 COMMISSIONER CRUMPTON: Okay. Your initial

1 comments.

2 FURTHER QUESTIONS BY COMMISSIONER CRUMPTON:

3 Q. I'm on Page 23.

4 A. Okay.

5 Q. Okay. Mr. Kind, I'm intrigued by the
6 comments of Office of the Public Counsel on the
7 section relating to the standards where you reference
8 the transfer of trained employees.

9 A. Right.

10 Q. And I'm a little concerned. What do we mean
11 by a trained employee, and how can we tell a trained
12 one from an untrained one?

13 A. Well, I guess a general answer would be an
14 employee who has -- has gained some skills, unique
15 skills, that would be of significant value to an
16 unregulated affiliate.

17 Q. Okay. Would this apply to skills learned on
18 the job in the normal course of his former job?

19 A. Definitely. For instance, somebody who's
20 been active in being a -- working in the trading room
21 in the power -- in a wholesale power operation of a
22 regulated utility, somebody like that. I wouldn't say
23 it would be -- it wouldn't make sense for it to apply,
24 for example, just to clerical skills, something like
25 that.

1 Q. Right. Well, I guess -- now, I can
2 understand if it was an employee who was sent to EEI's
3 power school as an example, let's say, six months ago,
4 and we're getting ready to transfer him, and we really
5 didn't use him very much in the current position. I
6 can understand transferring the cost of that training.

7 Is that the way we would do it? We would
8 transfer the cost of the training that that person
9 received that could be identified?

10 A. Well, I think that's -- that's sort of
11 the -- the sort of concept that's in the Commission's
12 proposed rules, that you would look at that sort of
13 thing.

14 Public Counsel's proposal that -- that
15 addresses this subject recommends that there just
16 be -- instead of having to keep track of what the
17 training costs are -- for instance, yesterday there
18 was a discussion that Commissioner Murray talked about
19 over a period of 15 years, how do you keep track of
20 all of that --

21 Q. I wanted to pursue that yesterday, but I
22 couldn't.

23 A. With our proposal there is no need to track
24 that.

25 Q. Okay.

1 A. You just take 25 percent of his current
2 salary, and you just -- it's just -- you make the
3 assumption that that's a good estimate of the training
4 costs. I think there is the possibility of somebody
5 showing that that's maybe not -- not a good
6 assumption. I don't have that particular section in
7 front of me right now.

8 Q. Okay. I'm looking at the middle paragraph
9 that begins "OPC embraces the concept." The very last
10 line --

11 A. And you are on Page 26. Right?

12 Q. Twenty-three.

13 A. Okay. I'm sorry. The -- okay. The
14 paragraph that begins "OPC embraces," yes.

15 Q. Accordingly, the OPC is proposing the
16 assessment of a one-time fee equivalent to 25 percent
17 of the transfer of the employee's base compensation to
18 be paid by the affiliate to the utility.

19 Now, my understanding is we are transferring
20 the employee. Right?

21 A. Right.

22 Q. Now, 25 percent of their base compensation,
23 I would think that -- explain to me, what do you mean.
24 What is the base compensation?

25 A. Okay. Well, for example -- well, it

1 wouldn't include something like a stock option.

2 Q. Right.

3 A. But, for example, someone's annual salary is

4 \$80,000.

5 Q. Oh, the prior annual salary?

6 A. Right, right.

7 Q. Oh, okay. I'm with you.

8 A. Right.

9 Q. So it would be -- 20,000 would be

10 transferred as the fee to --

11 A. Correct.

12 Q. Okay. I think that takes care of it.

13 A. And those provisions are actually -- where

14 we proposed them are that they become new Sections D

15 and E to the Standards Section of the rule that's in

16 our proposed rule.

17 COMMISSIONER CRUMPTON: Okay. Thank you.

18 That takes care of my questions.

19 MR. KIND: Sure.

20 COMMISSIONER CRUMPTON: Thank you, Judge.

21 JUDGE THORNBURG: Commissioner Murray, do

22 you have any follow-up?

23 COMMISSIONER MURRAY: No. Thank you.

24 JUDGE THORNBURG: Thank you, Mr. Kind.

25 (Witness excused.)

1 JUDGE THORNBURG: I'd ask Staff at this time
2 if they are prepared to proceed?
3 MS. SHEMWELL: We are.
4 JUDGE THORNBURG: Do you have any
5 statements, issues, Ms. Shemwell? Any additional
6 statement or --
7 MS. SHEMWELL: We will offer Dr. Proctor. I
8 don't have any additional statements.
9 We will have time to answer Commissioner
10 Drainer's question at some later point.
11 JUDGE THORNBURG: Okay. Mr. Proctor.
12 MS. SHEMWELL: I have a handout, a summary
13 of Dr. Proctor's comments, that we would make
14 available to the Commissioners and anyone who would
15 like a copy.
16 JUDGE THORNBURG: Dr. Proctor, would you
17 raise your right hand?
18 (Witness sworn.)
19 JUDGE THORNBURG: Thank you.
20 You may be seat.
21 Again, if you will just briefly introduce
22 yourself and then we'll allow you to present your
23 prepared testimony and then there will be some
24 questions.
25 DR. PROCTOR: Okay. My name is Michael S.

1 Proctor. I'm chief regulatory economist in the
2 Electric Department, but the comments that I've
3 written apply to steam, electric and gas.

4 What I'd like to go over just real briefly
5 is what I see as the basic economic issues that have
6 been raised in this proceeding by testimony that has
7 been presented on the behalf of Ameren's witness. And
8 the basic economic principles have -- that have been
9 raised there are economies of scale and scope that
10 would potentially provide a competitive advantage for
11 the utility and whether the utility should be allowed
12 to take -- use that competitive advantage.

13 And I think there's two principles -- or two
14 questions that need to be asked, and I think both of
15 those questions have to be answered in order to make
16 that determination.

17 And, first of all, do the economies of scale
18 and scope exist because of the utility's unique status
19 as a regulated monopoly? Did those economies come
20 from that? Did their potential competitive advantage
21 come from that?

22 If the answer to that question is yes, then
23 you need to turn to a second question, and that
24 question is, can those -- can that advantage -- can
25 those economies be effectively duplicated by

1 competitors, or is the cost too great or -- or very
2 great in time or resources?

3 And these are level playing field issues,
4 and I agree with Ameren's witness in the definition of
5 level playing field. I think we're looking at
6 competitors. We're looking at the competitive
7 environment. We're not trying to protect competitors.
8 We're trying to protect the environment that's there.

9 Real briefly on the -- and I'll come back to
10 these -- these concepts, but on the cross-
11 subsidization, the fully allocated costs versus what I
12 call good business practice, because I think that's
13 what the proposed rule looks at, and -- I think we
14 really need to ask the question, do we really believe
15 the SEC fully allocated cost requires the affiliate to
16 sell to an affiliate at below market price, and I
17 think the answer is no, that their rule does not
18 require that, nor does it require -- that rule require
19 the utility to buy from an affiliate at an above
20 market price.

21 Now, if it does, we better go to the SEC and
22 get the rule changed, because there is something wrong
23 with that. That's just not good business practice.
24 And what -- and that's really all I'm going to say on
25 cross-subsidization and the pricing rule. I think we

1 just use common sense and look at what is good
2 business practice.

3 On preferential access, which is part (2) (B)
4 of the rule, Ameren raises the essential and exclusive
5 argument versus what the Staff would call unfair
6 competitive advantage, but I want you to look at the
7 words, very important. They define "essential" as
8 services and facilities that cannot be practicably or
9 efficiently duplicated by each competing firm in the
10 market. Notice, that's very similar to Question
11 No. 2. Can it be effectively duplicated by
12 competitors, or is the cost too great in time and
13 resources?

14 They talking about information. They said
15 exclusive information is information of the
16 competitive significance about a utility's regulated
17 operations which is required because of its regulated
18 monopoly status.

19 Those were their definitions, and, again,
20 I'd have you look at Question No. 1, which says, did
21 you get the economies of scale or scope because of a
22 unique status as being a regulated monopoly? So I
23 think in concept we're not in disagreement.

24 Down below the box in the handout, we define
25 preferential service as information or treatment or

1 actions by the regulated electric corporation which
2 places the affiliate entity at an unfair competitive
3 advantage over its competitors. And in our
4 comments -- reply comments on Page 33, I just wanted
5 to point out that we corrected a problem that
6 Commissioner Murray raised yesterday in the
7 proceedings that repetitiveness about information or
8 treatment that got -- I think got repeated in the
9 rule, and we have proposed to change that.

10 We also on Page 33 -- Kansas City Power &
11 Light had raised comments about vagueness. What do
12 you mean by "unfair advantage"? And we have proposed
13 a definition of "unfair advantage." On this handout,
14 it says "unfair competitive advantage." That's the
15 economist in me. I want to stick the "competitive" in
16 there. And the definition is, "Any advantage that
17 cannot be obtained by a non-utility affiliated entity
18 or can only be obtained at great cost in either time
19 or resources."

20 If that definition is added and all
21 preferential service is -- preferential access is
22 excluded by the rule, then I think in terms of the
23 economics we're not really different from what
24 Ameren's proposing in concept.

25 Here's the difference, and that's in the

1 box. The difference is Ameren as an opponent, and
2 some of the proponents are also proposing to list what
3 all of these things are in the rule. What are the
4 essential services? Let's list them in the rule right
5 now and say what they are. And some people want the
6 list to be very small; some people want the list to be
7 very large.

8 The Staff has proposed a rule that would --
9 and I will admit it, would require a case-by-case
10 determination of what those things are at some future
11 date. In other words, it's a conceptual rule. It
12 lays out the concept. No competitive -- no
13 competitive advantage. Okay?

14 We're going to argue over -- at some point
15 in the future, we will argue over whether that
16 includes using the firm's logo or its name. We will
17 argue in the future about whether it includes using
18 the utility's billing system, those types of things.

19 Staff believes that that is a preferable way
20 to go rather than try to list all of those things.
21 First of all, I'm not sure that we have seen this
22 thing set up as a proceeding in which we're going to
23 sit down and take specific evidence about every
24 element that goes on the list and whether or not it
25 meets the definition of "unfair competitive

1 advantage."

2 I think you need to get that kind of

3 testimony, I'll use it, into the record to make a

4 determination that in the rule what you ought to do is

5 say, this is the concept, and then it gets applied as

6 we go through time.

7 So I think those -- I don't think the

8 economics are different, but I think it may be the

9 application, and whether we come up with a list now or

10 whether we come up with a rule that lays out the

11 concepts. And that completes my initial remarks.

12 JUDGE THORNBURG: Commissioner Drainer?

13 COMMISSIONER DRAINER: I have no questions.

14 Thank you.

15 JUDGE THORNBURG: Commissioner Crumpton?

16 COMMISSIONER CRUMPTON: None.

17 JUDGE THORNBURG: Commissioner Murray?

18 COMMISSIONER MURRAY: I have a few. Thank

19 you.

20 QUESTIONS BY COMMISSIONER MURRAY:

21 Q. Good afternoon, Dr. Proctor.

22 A. Good afternoon.

23 Q. On your handout --

24 A. Yes.

25 Q. -- under "Basic Economic Principles," it

1 appears to me -- although I realize you said that's
2 not what you're doing, but it appears to me that that
3 involves protecting competitors to the possible
4 detriment of customers who could benefit from the
5 economies of scale and scope of the utility. Would
6 you comment on that?

7 A. Sure. The problem is if I have a service
8 that cannot be duplicated because -- by others because
9 of great cost in time and resources, what pressure --
10 what economic pressures are there on me then to offer
11 it at that low cost? See, there is nobody there that
12 can push me. There is nobody there that can get me to
13 offer it at that low cost. So what I do with that
14 competitive advantage, it turns into profit for me.

15 Now, I don't see how that benefits the
16 consumer, so what you're trying to do is protect the
17 competitive environment so that, yes, if somebody has
18 a competitive advantage because of economies of scale
19 or scope, but other people can gain that as well, then
20 I have some competition that will benefit consumers,
21 but if nobody else can get it, that's not going to put
22 pressure on the market to bring it about. So
23 that's -- that's where I'm coming from on that.

24 Q. That's going to take some thought, so I
25 won't follow up on that right now.

1 On your cross-subsidization section there --

2 A. Yes.

3 Q. -- am I reading this backwards, or is that
4 stating the reverse of the way that you intended to
5 state it?

6 A. No. What I intended it to be is a question
7 that you ask, and the answer is no.

8 Q. But the question -- the first question,
9 should SEC fully allocated cost require the utility to
10 sell to an affiliate at below market price, and I
11 would think -- I don't know. Maybe I'm -- maybe I'm
12 misunderstanding what it is you're trying to say
13 there, but I -- I would think the question you would
14 be posing is, should the SEC fully allocated cost
15 require the utility to sell to an affiliate at above
16 market price, to sell to the affiliate above and to
17 buy from the affiliate below?

18 A. If a utility is selling, okay, essentially
19 what it's selling is a byproduct of its regulatory
20 activities, and what it wants to get is the maximum
21 price that it can get for that product because
22 those -- the revenues from that then go back to
23 decrease the cost to the ratepayer.

24 So our concern is going to be if a utility
25 is selling something -- well, let me give you an

1 example. Suppose they are selling power in the
2 generation market. We want them to maximize the price
3 that they can get for that power. Okay? We don't
4 want them to do an embedded cost assignment of that
5 power when the market price is \$50, \$60 a megawatt
6 hour, or \$100 a megawatt hour.

7 That's what the market price is. That's
8 what they should be selling it for, not for the
9 embedded cost of that power, which would just be the
10 variable cost and some return to their capital
11 investment.

12 So that's the way -- why I've framed it the
13 way it's framed is I don't think you ought to
14 interpret a fully allocated cost -- costing rule to be
15 one that requires a utility to sell at below market
16 price, because we want them selling at market price.

17 Q. Let me take a minute and look at the rule as
18 it references.

19 Under (2) (A) of the rule, "A regulated
20 corporation would be deemed to provide a financial
21 advantage to an affiliated entity if it compensates
22 the affiliate above the lesser of the fair market
23 value, fair market price or fully distributed cost."

24 A. That's when it's buying it. Under (A) (1)?

25 Q. Right, if it's buying. Okay.

1 A. Yeah. Because it's paying the affiliate for
2 something it's purchasing, so -- and in that case we
3 don't -- we don't want the utility buying from the
4 affiliate at something that's above market price.
5 They ought to be buying from the market.

6 Q. Okay. Well, I guess what I don't understand
7 is the point that you're making with your cross-
8 subsidization example there because --

9 A. Well, Ameren is arguing that this rule is in
10 conflict with the SEC rule, and we've argued in our
11 reply comments that it's now, that the SEC rule does
12 not require these two things to occur.

13 Q. Okay. Thank you.

14 From a -- from an economist's standpoint,
15 why is it necessarily -- why would an affiliate
16 transaction be something that we would consider bad if
17 it did not cost the ratepayers anything?

18 A. One potential -- it depends on what you
19 mean, costs the ratepayer anything. Economists look
20 at costs in terms of opportunity costs, unfortunately
21 maybe, but -- so when we say costs the ratepayer
22 anything, we don't mean it wouldn't raise their rates.
23 What we mean is that they didn't get the full benefit
24 that they should have gotten.

25 Q. In other words, perhaps the benefit of

1 having another entity in the marketplace to buy from?

2 A. Perhaps. But in terms -- in terms of the
3 first part of the rule, it would be -- going, again,
4 back to the example, when you're selling something as
5 a byproduct of their regulated activities, if they
6 didn't maximize the amount of profit that they would
7 get from that, that would be an opportunity cost to
8 the ratepayer. The ratepayer wouldn't get the full
9 benefit of it.

10 Q. But under your -- under this proposed rule,
11 if the regulated utility wants to sell something to an
12 affiliated entity and the fair market price -- and the
13 fully distributed cost is greater than the fair market
14 price --

15 A. Okay.

16 Q. -- the utility could -- if the utility sold
17 to any nonaffiliated entity, they couldn't expect to
18 get more than fair market price?

19 A. Fair market price.

20 Q. Correct. But under this rule, they would be
21 considered to be giving their affiliate an advantage
22 if they sold it to their affiliate at fair market
23 price if the fully distributed costs were greater than
24 fair market price. Correct?

25 A. That's correct. In -- the principle there

1 is in those -- in those transactions, the utility
2 is -- within the corporation, the utility is entitled
3 to get full recovery of its cost. It's the
4 asymmetrical pricing problem that was talked about
5 earlier this morning. The principle that's being
6 applied there is within -- within the corporation it's
7 entitled to full recovery of its costs.

8 Now, the point is, if they were involved in
9 this business and their full allocated costs were
10 below market price, or above market price, they
11 probably shouldn't be staying in this business very
12 long, and that the affiliated entity, as good business
13 practice, would be and should be purchasing that from
14 outside at market price.

15 Now, again, remember, you can get waivers
16 from the rule, so if -- if, for example -- and it's
17 hard for me to think of specific examples. But if,
18 for example, this was something that the utility was
19 just starting to do, and its fully allocated costs in
20 that year were very high, it could ask for a waiver.
21 In other words, it needs to establish this business
22 over time and get down to a fair market value.

23 But, yes, there can -- when you have
24 asymmetrical pricing, there can be instances where the
25 utility needs to come in and ask for a waiver. And I

1 can't pretend to think of what all of those are, but
2 I've tried to give you an example of one.

3 Q. Do you think that would be the case very
4 often, or --

5 A. No. I think most of the time, because of
6 the economies of scale and scope of the utility, they
7 are going to be -- they are not going to have
8 difficulty in providing byproducts from their
9 regulated activities at a fully allocated cost that
10 was below market price.

11 Q. Okay.

12 A. At or below.

13 Q. If we were to require that the utility did
14 not sell below the incremental cost --

15 A. Incremental cost, okay.

16 Q. -- did not sell to an affiliate below its
17 incremental cost, why would -- why would that not
18 protect the ratepayers adequately?

19 A. It would protect them in the sense that no
20 additional cost would be put onto the ratepayers, but
21 it wouldn't maximize the -- it wouldn't maximize the
22 revenues that the regulated firm could get for selling
23 its product to come back to -- to the ratepayers to
24 lower their costs.

25 For example, utilities have power plants.

1 There are times -- a lot of times during the year that
2 those power plants would sit idle unless the utility
3 was selling power in the wholesale power market. If
4 the rule was the ratepayer only gets reimbursed for
5 the incremental cost, then -- then it's true. The
6 ratepayer wouldn't have to pay for the incremental
7 costs, the additional fuel and so forth to run the
8 plant. But they would also be getting no return on
9 the use of that plant. They would be getting no
10 profit from that plant as it gets used in the market.

11 And so while the incremental price rule
12 protects you from -- from making costs go up, it
13 doesn't maximize the return that comes to the
14 ratepayer. And by the -- in that sense, the ratepayer
15 is paying for that plant in their -- in their embedded
16 cost payments.

17 Q. Okay. Do you think that this is the least
18 restrictive rule that could be written to accomplish
19 the legitimate goals here?

20 A. I really -- I really don't know if I can
21 answer that question. I'm sure people could come up
22 with rules that are less restrictive than this one.
23 For example, one might say that the rule proposed by
24 Ameren is less restrictive. The problem that I have
25 with that is in laying out the specifics at this point

1 in the rulemaking.

2 Now, I think from a conceptual rule it may
3 be one of the least restrictive. It does not require
4 corporate restructuring. It doesn't require -- it
5 doesn't prevent the utility from being involved in
6 nonregulated business. So I think it has the
7 potential of gaining the benefits of economies of
8 scale and scope in the market because of that.

9 And a lot of states have required total
10 separation. This rule doesn't do that. So in that
11 sense, it's not nearly as restrictive as some other
12 rules have been. Whether it's the least restrictive,
13 I really haven't evaluated that.

14 Q. Do you think it's a good idea for regulatory
15 bodies to impose the least restrictive rules possible
16 in order to accomplish their purposes?

17 A. If they sense -- if there is a sense that,
18 in fact, those rules will accomplish that. I think
19 usually the argument is going to be over what the
20 purposes are. And -- and I think what this rule is,
21 it sets out the concepts, and then it says, we -- at
22 some future time we know we're going to have some
23 arguments about the implementation of this and whether
24 it accomplishes the conceptual goals that were laid
25 out here.

1 Q. Do you have any problem with the corporate
2 support language that was discussed earlier when
3 Mr. Kind was on the stand? And I believe -- no, it
4 was the OPC's other witness, and I've forgotten --
5 Dittmer. Mr. Dittmer.

6 A. I think the Staff in its reply comments set
7 out its view on the corporate support, and I think its
8 view is the way the rule is written right now, we
9 don't see corporate support -- having to lay corporate
10 support out as a separate item as something that's
11 needed. I don't think there is a big issue or problem
12 with that on the part of the Staff.

13 Q. Pardon me, but you don't think there is a
14 big problem with putting it in?

15 A. With putting it in as an exception to the
16 rule. I haven't asked everyone of the Staff that's
17 been involved with that, but I have read their reply
18 comments to it, and I don't know if I can --

19 Q. Let me ask you this: It's not Staff's
20 intent to require corporate restructuring?

21 A. No. Absolutely. Right. It's not our
22 intent to require corporate restructuring. That's
23 correct.

24 COMMISSIONER MURRAY: Thank you.

25 I believe that's all of my questions.

1 JUDGE THORNBURG: Commissioner Drainer, do
2 you have a question?

3 COMMISSIONER DRAINER: No, I have no
4 question. I have a lot of questions, but I won't go
5 on and ask them.

6 JUDGE THORNBURG: Commissioner Crumpton?

7 COMMISSIONER CRUMPTON: Well, I'll ask them
8 for her.

9 COMMISSIONER DRAINER: Thank you.

10 COMMISSIONER CRUMPTON: You're welcome.

11 QUESTIONS BY COMMISSIONER CRUMPTON:

12 Q. Dr. Proctor, I'm concerned about the
13 record-keeping issue and the reason we need to keep
14 good records, and on the anticompetitive effects of
15 having affiliates dealing with each other in ways that
16 cost the public money. Now, if the UE appliance
17 installation garage -- and that's the garage where
18 they house the vehicles that install air conditioners
19 and electric furnaces -- uses power from UE, is it
20 your position that UE should charge them the same
21 price that they would charge the Adams Appliance
22 Company down the road or Sears and Roebuck, for that
23 matter?

24 A. That would be my position, yes.

25 Q. And the reason is that the UE appliance

1 installation garage would have a lower cost of energy
2 than the Adams Appliance Company, for no reason other
3 than the fact that they are related to UE?

4 A. That's correct. If you didn't charge them
5 the same rate, you would probably charge them
6 something cheaper.

7 Q. So what we're trying to do is to -- with
8 this record-keeping create an environment where
9 competitors compete on the basis of the service they
10 provide but not any hidden agreements anywhere.

11 A. That's correct.

12 Q. Like I recall -- I think it was Standard Oil
13 had an agreement with the railroads where Standard Oil
14 would sell -- I'm sorry -- yeah, Standard Oil would
15 sell its oil to its customers at prices that everybody
16 was aware of, but at the end of the year, the
17 railroads would give them a big kickback. And so,
18 therefore, Standard Oil was getting a much better
19 profit and able to survive when the others would go
20 under, because they couldn't afford it.

21 So that's the reason we need to make sure
22 that these competitors are facing the same issues in
23 the marketplace?

24 A. That's correct.

25 Q. Okay. Now, on the issue of economies of

1 scale and scope, the reason these companies merge is
2 because they are going to save a lot of money by
3 lopping off or reducing their joint and common costs
4 overall? In other words, you have two presidents, you
5 bring them together. You only need one, so you lop
6 off one, and you have one left. And that one
7 president now serves the two enterprises. So both
8 enterprises shared a joint and common cost?

9 A. That's one of the reasons, yes.

10 Q. Okay. So if we have the UE -- and maybe
11 I'll change that.

12 If we have the Adams Electric Company
13 selling something to one of its affiliates and they
14 are sharing joint and common costs, whereas the -- the
15 competitive appliance company down the street is doing
16 the same kind of work, they would have to pay their
17 president and reflect it in the price they charge
18 their customers; whereas, the affiliate in their
19 regulated company would avoid that?

20 A. Yeah. What you're talking about in your
21 example is something that's in the press today with
22 respect to farms, and it has to do with big business
23 versus small business.

24 Q. So we're trying to save -- this rule is
25 trying to protect --

1 A. Not really.

2 Q. -- all of the players? All of players.

3 A. It's trying to make the playing field a
4 level playing field. It won't necessarily protect
5 small -- it will not protect small business.

6 Q. Okay. All right. On this issue of the
7 transfer of employees, I'm a little confused. And I
8 think the reason you're here is to help clear up this
9 confusion.

10 A. I hope so.

11 Q. What is Staff's proposal on the transfer of
12 employees?

13 A. Staff includes -- or it's included in the
14 rule -- let's see if I can -- it's -- wrong page.

15 Q. Take your time.

16 A. It's included in the rule, I believe. Is it
17 (2) (D)? No.

18 Oh, I'm sorry. It's under (2). It's
19 talking about providing financial advantage if it
20 transfers information, assets, goods or services of
21 any kind, including, but not limited to land, patents,
22 trained employees, research, employee training,
23 et cetera.

24 In my comments, I -- I felt like maybe that
25 should be changed to trained employee services. In

1 the concept there -- and I think there is two
2 concepts, trained employee services and employee
3 training, and those are two different things.

4 Trained employee services, if you have
5 someone working for the utility who, for a period of
6 time, is loaned out to an affiliate, then the utility
7 needs to be compensated for the use of that employee's
8 services during that time.

9 The employee training, on the other hand,
10 is, I think, the issue that you were talking with
11 Mr. Kind about, which is, what if you have a trained
12 employee that gets hired away by the utility, and now
13 the utility has to train another employee to take that
14 employee's place? And I think the Staff's position is
15 that they should be compensated for that then.

16 Q. How?

17 A. We would say look at the cost of recruiting
18 and training the employee, and that would be the cost
19 that they would get compensated for.

20 Q. But how would you do that? Would that not
21 be sort of arbitrary? Two people looking at the same
22 employee might value it differently.

23 A. Well, here's the way -- if I can go to the
24 market and hire someone who's trained to come into
25 that position, then I don't think there would be any

1 compensation going back and forth.

2 I think what we're concerned about, or the
3 Staff was concerned about is, what if -- what if an
4 employee is taken away? I can't go to the market and
5 hire someone with that same level of training and
6 competence, and so now I have to hire someone to come
7 in, but now I have to provide them with training.

8 Then you would know what the cost of that
9 training is. You would know what the cost of having
10 to go out and recruit is. And so those would be the
11 costs that you would be compensated for. That would
12 be how you would be compensated.

13 Q. Well, suppose the employee just quit --

14 A. Uh-huh.

15 Q. -- and was recruited by a competitor?

16 A. That's --

17 Q. Then you wouldn't have a transfer, would
18 you?

19 A. There would be no transfer.

20 COMMISSIONER CRUMPTON: Okay. Thank you.

21 DR. PROCTOR: Thanks.

22 JUDGE THORNBURG: Commissioner Murray, do
23 you have any follow-up?

24 COMMISSIONER MURRAY: I don't think so.

25 JUDGE THORNBURG: I think that's all at this

1 time, Dr. Proctor.

2 DR. PROCTOR: Thank you.

3 (Witness excused.)

4 JUDGE THORNBURG: Ms. Shemwell, did you have

5 any other witnesses to present at this time?

6 MS. SHEMWELL: We do not. Thank you.

7 JUDGE THORNBURG: Thank you.

8 I will call on Enron Corporation and

9 Mr. Johnson.

10 MR. JOHNSON: Yes, sir. I have a witness.

11 Mr. Reichelderfer will be here from Enron. He

12 prepared and filed the comments that we previously

13 filed with the Commission.

14 (Witness sworn.)

15 JUDGE THORNBURG: If you will briefly

16 introduce yourself and present your prepared comments,

17 and then be prepared for questions.

18 MR. REICHELDERFER: Thank you, your Honor.

19 Members of the Commission, I appreciate the

20 opportunity to speak here today.

21 I represent Enron Corp, but more

22 specifically Enron Energy Services, which is the

23 competitive subsidiary of Enron Corp that supplies

24 electricity and natural gas to various consumers

25 throughout the United States, including natural gas

1 consumers here in Missouri.

2 I will make my comments very succinct. The
3 witnesses that went before me did an excellent job in
4 discussing the specific issues. What I would like to
5 do is maybe take it a little bit -- to a level higher,
6 maybe the 50,000-foot level, and talk about some
7 general concepts a little bit more and the importance
8 of affiliate rules in the competitive marketplace.

9 As I mentioned, Enron Energy Services is a
10 competitive supplier. We have participated in
11 numerous code of conduct affiliate rules throughout
12 the United States, both at the federal and state
13 level, and consider it to be an essential part of --
14 or an essential ingredient in preventing
15 anticompetitive behavior in a competitive energy
16 industries.

17 Effective affiliate rules must not only
18 address issues dealing with the commodity, meaning the
19 electricity and natural gas and access to distribution
20 and transmission facilities, but also other energy-
21 related services, such as energy management, energy
22 auditing, demand-side management, appliance sales.
23 Other than HVAC services, which have been addressed in
24 a different rulemaking proceeding, all of these can
25 benefit from the sharing of confidential information

1 and preferential access to utility goods and services.

2 As was discussed earlier, utilities have
3 already begun to diversify into some of these
4 operations, and this is occurring regardless of
5 whether retail compensation has been implemented in a
6 particular state or not.

7 Enron commends the efforts of the Commission
8 Staff in drafting the proposed rules and addressing
9 the key issues of cross-subsidization,
10 nondiscrimination and proper information sharing, but
11 Enron would suggest that a couple of additional
12 provisions need to be included that address structural
13 separation of the regulated utility from the affiliate
14 and appropriate regulatory oversight, meaning
15 complaint procedures, compliance plans, compliance
16 audits, et cetera.

17 Enron would encourage the Commission to take
18 a look at some of the suggestions it made to the
19 revised produced rules in its initial comments.

20 It's often argued that a light-handed
21 approach should be used when implementing affiliate
22 rules. I think experience has shown both at the state
23 and federal levels that this approach does not prevent
24 affiliate abuse and discriminatory behavior.

25 For example, recently, I think we've seen it

1 at the federal level with the FERC in its issuance of
2 the RTO NOPR which they've acknowledged the fact that
3 the affiliate guidelines as promulgated in FERC
4 Orders 888 and 889 were not enough to prevent
5 affiliate abuses at the wholesale level.

6 Enron further strongly supports the comments
7 filed by the OPC with very few exceptions and would
8 encourage the Commissioner to consider the OPC's
9 positions and rationale for those positions when
10 determining the appropriate affiliate transaction
11 rules.

12 As a marketer, when it is determining
13 whether or not to enter a particular market, it looks
14 at a number of factors. You can kind of group those
15 all together under the -- under the term of "market
16 structure."

17 One of those key aspects to that -- to that
18 determination is whether or not there are affiliate
19 rules in place and how comprehensive and how effective
20 those are. That's coupled with structural separation.

21 A state or market that does not have
22 effective rules in place, a marketer would be very
23 hesitant to enter those markets, which, ultimately,
24 will reduce or prevent a competitive market from
25 flourishing.

1 That's some general comments I wanted to
2 make. I would be welcome to answer any questions that
3 you may have.

4 JUDGE THORNBURG: Commissioner Drainer?

5 COMMISSIONER DRAINER: I have no questions.

6 JUDGE THORNBURG: Commissioner Crumpton?

7 COMMISSIONER CRUMPTON: I have no questions.

8 JUDGE THORNBURG: Commissioner Murray?

9 COMMISSIONER MURRAY: I don't believe I have
10 any either.

11 JUDGE THORNBURG: I don't have any
12 questions.

13 We thank you for your comments.

14 MR. REICHELDERFER: Thank you.

15 JUDGE THORNBURG: And we thank you for being
16 here today.

17 (Witness excused.)

18 JUDGE THORNBURG: Mr. Downey, you didn't
19 have any witnesses you brought with you today. Did
20 you have any comments you wanted to offer at this
21 time?

22 MR. DOWNEY: No, I didn't. I do not. Thank
23 you.

24 JUDGE THORNBURG: Okay. Are there any other
25 proponents here to the rule or any other witnesses

1 that would like to testify in support of the rule?

2 (No response.)

3 JUDGE THORNBURG: I think rather than take a

4 break at this point, we'll move on with at least the

5 next witness.

6 At this point we're going to take opponents

7 of the rule. And we're going to go just a little bit

8 out of order to make sure we don't run into a time

9 problem later.

10 I'd call on Mr. Gerald Reynolds at this

11 point. Do you have any comments or a witness you

12 would like to offer at this time?

13 MR. REYNOLDS: Okay. I don't have any

14 comments, but for the sake of brevity, I would like to

15 offer the written statements of our witness,

16 Mr. Mahinka. Rather than have him read his testimony,

17 he will -- if we could submit his written comments as

18 an exhibit, he would just provide a synopsis and field

19 any questions you may have.

20 JUDGE THORNBURG: Will his summary today

21 cover -- I mean, he'll summarize these written

22 comments --

23 MR. REYNOLDS: That's correct.

24 JUDGE THORNBURG: -- being added to the

25 record today?

1 MR. REYNOLDS: Yes.

2 JUDGE THORNBURG: And if he testified fully,
3 he would just be reading these into the record today?

4 MR. REYNOLDS: That's correct.

5 JUDGE THORNBURG: Okay. I think that would
6 be appropriate, unless there is some objection to
7 that.

8 (No response.)

9 JUDGE THORNBURG: Okay. It would be fine.

10 MR. REYNOLDS: Okay. I will just provide
11 you with a copy.

12 JUDGE THORNBURG: If the court reporter
13 would mark this as the next numbered exhibit, we'll
14 make that part of the record.

15 (EXHIBIT NO. 2 WAS MARKED FOR
16 IDENTIFICATION.)

17 MR. REYNOLDS: At this point I would like to
18 offer KCP&L's witness, Mr. Mahinka.

19 JUDGE THORNBURG: Mr. Mahinka, if you would
20 come forward, please?

21 Raise your right hand, please.

22 (Witness sworn.)

23 JUDGE THORNBURG: Thank you. You may be
24 seated.

25 If you will briefly introduce yourself, and

1 I know you have a summary of your testimony you would
2 like to offer today, and then we'll ask questions
3 next. Thank you.

4 MR. MAHINKA: Thank you, Judge Thornburg.

5 I appreciate very much the opportunity to
6 appear before the Commissioners and yourself. You
7 have a very great responsibility, a very difficult one
8 knowing the restructuring of this industry that's
9 taking place, and I appreciate the opportunity to
10 provide some suggestions to you.

11 I'll try to be brief and focus on some
12 specifics.

13 My name is Steve Mahinka. I am a partner in
14 Morgan, Lewis & Bockius, in our Washington, D.C.
15 office. I am the manager of our antitrust law
16 practice and some of the related practices, and I've
17 practiced antitrust law for about 25 years.

18 Most of my work in the antitrust area is in
19 regulated and deregulated industries, and I have been
20 fortunate to be able to go through the various of the
21 restructuring such as natural gas, trucking and
22 airlines. I do not know this Commission's procedures,
23 but I believe the Commission's focus here is the same
24 as that of the antitrust laws, which is on consumer
25 welfare.

1 As Judge Thornburg said, I have submitted a
2 prepared statement. Mercifully, and by popular
3 demand, I think, from KCP&L, I will not read that
4 statement, but I'll try to summarize it for you.

5 I'd like to make one point at the outset
6 which is, antitrust law is often made to seem quite
7 complex. Antitrust lawyers, of course, like this. It
8 enables us to charge extremely high fees, but the
9 simple focus is this for antitrust law: There is one
10 question, which is, what is the effect on price? And
11 I think that's the thread I'd like to bring through
12 the remarks today.

13 Many of the proposed restrictions on
14 affiliate transactions that you have heard about
15 decrease efficiency and thereby increase price. Now,
16 that should and can, in my view, be a clear signal to
17 this Commission which needs to decide whether to
18 impose that cost by adopting a particular proposed
19 restriction.

20 I want to make two central points throughout
21 the remarks that I make. First, the Commission's rule
22 should not hinder economic efficiency because
23 efficiency promotes consumer welfare. And, second, in
24 order to promote competition to enhance efficiency and
25 to maximize consumer welfare, this Commission should

1 adopt affiliate transaction rules that are narrowly
2 targeted to the problem of cross-subsidization and do
3 not overreach.

4 As long as a utility affiliate, in my view,
5 bears the costs of producing the good or service that
6 it sells, the problem of cross-subsidies is resolved.
7 The only rule needed by this Commission is an
8 appropriate pricing rule for affiliate transactions
9 and a mechanism for ensuring compliance.

10 Rules that go beyond that are simply going
11 to impede the competitive process and harm rather than
12 help consumers.

13 Other detailed restraints also may be
14 premature for this Commission to adopt since Missouri
15 is not engaged currently in restructuring of electric
16 power markets. The issue of nondiscriminatory open
17 access that has been talked about by the Commission
18 Staff witnesses and the Office of Public Counsel
19 witnesses is not before this Commission.

20 You may wish to address these kinds of
21 matters differently at the proper time and tailor any
22 rules to the particular kind of restructuring that
23 Missouri chooses rather than prematurely at this
24 point.

25 Now, the specific restrictions proposed to

1 this Commission in many cases suffer from these
2 problems and should be rejected by the Commission. In
3 particular, I point to Section (2) (B) of the proposed
4 rules. Those rules are overly broad and would
5 prohibit an incumbent's use of legitimate
6 efficiencies. The rule in 2) (B) would prohibit any
7 preferential treatment by a utility toward an
8 affiliate.

9 Now, that proposed rule is, in my view,
10 completely backwards. Rather, so long as there is no
11 cross-subsidization, then utilities not only should be
12 permitted to give preference to their affiliates, they
13 should be encouraged to do so. Preferential treatment
14 increases economic efficiency and lowers costs because
15 only by this approach is consumer welfare going to be
16 enhanced.

17 The proposed rule in (2) (B) erroneously
18 considers a preference by a utility to its affiliate
19 through sharing assets or information to be a subsidy.
20 Every preference is not a subsidy. Cross-
21 subsidization does not mean prohibiting the transfer
22 of any benefits to an affiliate. Rather, it means
23 prohibiting the transfer of any costs to ratepayers.

24 Cross-subsidization does not occur so long
25 as the affiliate compensates the utility for the asset

1 and information transfers at a price at least equal to
2 incremental costs.

3 Commissioner Crumpton pointed out in his
4 questioning of the economist witness for the
5 Commission Staff exactly this problem. Ratepayers pay
6 for electricity. So long as incremental costs are
7 recovered, there is no cross-subsidies. Ratepayers
8 are getting exactly what they pay for. Ratepayers
9 have no further claim on the company's profits.

10 Comparing one firm's costs so long as it's
11 not the result of cross-subsidization and lower your
12 costs is pro-competitive and should be encouraged.
13 And to deny the utility the ability to use its
14 resources efficiently, simply subsidizes less
15 efficient suppliers and creates economic waste and
16 raises prices to the consumers who have to pay for the
17 waste.

18 Now, the Office of Public Counsel's specific
19 proposals which properly should be rejected, in my
20 view, by this Commission is detrimental to consumer
21 welfare. The OPC's exception to Section (2) (B) for
22 corporate support services does significantly improve
23 on their earlier proposed section by permitting
24 incumbents to use some economies of scale and scope,
25 but it does not go far enough.

1 Many functions continue to be excluded.
2 It's really the same point I made earlier in a general
3 way. As long as proper cost altercations are made
4 between regulated and unregulated operations, improper
5 cross-subsidization will not occur.

6 Most of the OPC-specific proposal rest on an
7 incorrect understanding of what barriers to entry are
8 in antitrust analysis. Not all factors that make
9 entry difficult properly can be labeled or are labeled
10 in antitrust analysis as anticompetitive barriers to
11 entry.

12 Lower prices occurring from lowering costs
13 and good service certainly discourage entry. But such
14 market behavior is pro competitive and enhances
15 consumer welfare, which is the object of the
16 Commission's proceeding here.

17 The OPC's arguments for restrictive rules
18 rest on this misunderstanding that certain practices
19 would erect barriers to entry in the retail markets.
20 I would like to go through five of these specific
21 proposals as I have in the written testimony.

22 First, there should be no restrictions on an
23 affiliate's ability to use its parents' company's name
24 and logo. That simply removes valuable information
25 from consumers. Any positive reputation that a

1 utility might have is only able to be sustained if the
2 utility continues to produce good value for the
3 consumers. If it doesn't, they will lose that
4 reputation and value.

5 And restrictions on an incumbent's utility
6 are the functional equivalent of a subsidy to new
7 entrant competitors like Enron Energy, many of which
8 will have substantial brand name recognition and
9 substantial resources and have been exceedingly
10 successful and need not be subsidized by this
11 Commission, and that would be the effect if the result
12 is to put in a rule like this that would raise the
13 utility affiliate's cost of establishing itself in the
14 marketplace by requiring a new name and logo to be
15 developed.

16 Second, requiring affiliates to provide
17 disclaimers and pay royalty fees to use a parent's
18 name would reduce economic incentives to invest in
19 good will and distort, as a result, proper resource
20 allocation from a consumer welfare perspective.
21 Commissioner Crumpton again identified this as a
22 problem in his questioning earlier.

23 Third, restrictions on billing inserts and
24 other joint advertising are also not justified. Here
25 again, as long as the costs are properly allocated

1 between the regulated and the unregulated affiliate,
2 joint advertising and promotion do not raise cross-
3 subsidy concerns. Again, rather, consumers will
4 benefit from the economies of scope that are inherent
5 in joint advertising and marketing.

6 Fourth, the sharing of customer information,
7 plant and equipment and employees between the utility
8 is -- and its unregulated affiliate is pro competitive
9 and enhances consumer welfare. As we pointed out in
10 KCP&L's reply comments at Page 21 and 22, any such
11 restrictions would certainly raise concerns as
12 violative of Missouri public policy about the ability
13 of employees to go from one corporation to another.

14 Now, unquestionably some tailored
15 restrictions on exchange of certain types of
16 information and sharing of certain types of employees
17 will be a legitimate concern with retail electric
18 power deregulation if and when Missouri considers it.

19 But, here again, such information and
20 sharing, if it lowers the cost of affiliates to
21 operate, is pro competitive as long as a proper
22 allocation of cost is made, and it should be
23 encouraged by this Commission.

24 Again, the example discussed in the
25 questioning of the Missouri witness Staff economist is

1 illustrative in this regard in my view. That just
2 occurred a few seconds ago.

3 If an employee who is trained were to be
4 hired by an unregulated affiliate of Kansas City
5 Power & Light, the proposal is there should be a
6 payment made to compensate the ratepayer for value
7 loss. However, if Enron Energy Services hires the
8 same trained employee with the same presumed adverse
9 effect on Kansas City Power & Light, there is no
10 payment that is intended to be made under these rules.

11 Now, again, at the beginning I said, just
12 look at everything in terms of the effect on price.
13 In that instance, Enron is getting a trained employee
14 for free, a subsidy by this Commission's rule, if it
15 is adopted that way. Another way to look at it is an
16 additional cost, not a cost borne by Enron if it hires
17 an KCP&L employee. An additional cost is put on only
18 the unregulated affiliate which is going to make it
19 unlevel and its playing field more difficult to
20 compete with Enron, and that seems inappropriate and
21 certainly unjustified in terms of competitive
22 analysis.

23 Finally, a rule against tying arrangements
24 is unnecessary and inappropriate. As proposed, it
25 would create inconsistent legal requirements.

1 Anticompetitive tying arrangements already are
2 prohibited under the federal antitrust laws if engaged
3 in by Missouri utilities and by the Missouri State
4 antitrust statute, which can be enforced by private
5 litigants or the federal government or the Missouri
6 Attorney General.

7 In addition, the Commission Staff's proposal
8 in its reply comments at Page 37 and 38 to adopt a
9 particular kind of tying arrangement prohibition
10 would, in my view, create inconsistent legal
11 requirements with the federal and state antitrust
12 laws. That proposal would go far beyond federal and
13 state antitrust requirements and prohibit practices
14 that benefit purchasers and consumers.

15 The Commission Staff recommends that this
16 Commission adopt a time provision prohibiting any
17 discount rebate or waiver of terms tied to the taking
18 of goods or services from an affiliate. That rule
19 would apparently prohibit package discounts, package
20 arrangements of goods or services at a lesser cost
21 than taking both things separately even where each
22 good or service is separately available for a
23 purchase.

24 That type of purchase discount, that type of
25 package discount -- it's called an antitrust

1 analysis -- is not prohibited under federal or
2 Missouri state antitrust law because it lacks the
3 required element of coercion of the purchaser.

4 For example, if you had Good A at \$10 and
5 Good B at \$10, both are available to purchase, KCP&L
6 could decide to offer a package arrangement, buy each
7 for 18. You can still buy each one separately.

8 By offering the package discount, it doesn't
9 coerce anyone to buy the package. It offers the
10 package at a lower price, and purchasers can select it
11 if they so desire and consumers can benefit from the
12 lower cost package.

13 To adopt the Commission's Staff proposals,
14 however, would result by precluding that potential in
15 higher prices and costs to consumers, and that kind of
16 proposal by the Commission Staff also should be
17 rejected by the Commission.

18 I really only have two concluding
19 suggestions. The Commission's focus properly ought to
20 be in this proceeding on ensuring proper cost
21 altercations that are made in order to control the
22 question and problem and concern of
23 cross-subsidization. That's really all that is before
24 us now.

25 And, second, additional restrictions on

1 affiliate transactions are not justified by
2 competitive analysis or antitrust economics and will
3 harm consumer welfare, and, thus, should be rejected
4 by this Commission.

5 Thank you very much. I would be happy to
6 answer any questions you might have.

7 JUDGE THORNBURG: Commissioner Drainer.

8 QUESTIONS BY COMMISSIONER DRAINER:

9 Q. Well, first, a comment. I wish to thank you
10 for giving us your prepared statement in written form.
11 That's very thoughtful and thorough.

12 Second, with respect to your comments and
13 your written statement, when you had your discussion
14 on incremental costs being defined as long-run
15 marginal costs, you go on to state that the use of a
16 fully distributed cost is a reasonable, workable
17 approximation of the incremental cost.

18 I just want to clarify. You do not find a
19 problem with using fully distributed costs?

20 A. That term -- two things, your Honor.

21 The first, the fully distributed cost isn't
22 a term that you use in antitrust analysis. You use
23 average value cost or marginal cost or average total
24 cost, so these are really much more in the nature of
25 accounting terminology.

1 But the proper focus ought to be, in my
2 view, long-run incremental costs. That's been
3 accepted in most cases involving allegations of
4 predatory pricing in regulated industries such as the
5 MCI/AT&T case when it was first adopted by the Seventh
6 Circuit many years ago, and it seems to be the right
7 one.

8 Some kinds of fully distributed cost
9 definitions, including certain of the ones that have
10 been adopted by KCP&L, seem consistent with that
11 without requiring average total costs. That really
12 would be a completely fully allocated cost, which
13 would simply be going too far, because you really
14 would be requiring people to charge very, very high
15 prices, and that wouldn't be very sensible.

16 Q. All right. But let's go back. I do
17 understand that you're saying that it's a fully
18 allocated cost, but when you're talking about fully
19 distributed costs, you're saying that that would be
20 closer to just a long-run incremental cost? And in
21 the long run all costs are --

22 A. Yes.

23 Q. -- variable.

24 A. Yes.

25 Q. And that's what you're trying to direct us

1 to. But at the same time, you're saying, don't step
2 so far as to define your fully distributed cost as
3 fully allocated costs?

4 A. Precisely.

5 Q. Okay. Then I guess what I would finally
6 have to ask you is, for the proposed rule, do you have
7 any problem with the definition for fully distributed
8 cost?

9 A. I think that's been covered in earlier
10 comments by KCP&L, and we don't, I think, have major
11 difficulties with it, as I recall. But I would have
12 to check the earlier filings.

13 Q. Well, again, thank you very much for your
14 comments and thank you for giving us the prepared
15 written statement. It was helpful.

16 A. You are welcome.

17 JUDGE THORNBURG: Commissioner Crumpton?

18 QUESTIONS BY COMMISSIONER CRUMPTON:

19 Q. Good afternoon.

20 A. Good afternoon, sir.

21 Q. I would like to discuss this long-run
22 incremental cost issue. Can you tell me what you mean
23 by "long-run incremental cost"?

24 A. As is often brilliantly done in economics,
25 the difference seems to be between short run

1 incremental costs and long run, so -- but the
2 difference between short-run and long-run is simply
3 the amount of time in which you look to see what costs
4 are variable.

5 The sense was in looking at regulated
6 industries that because the time horizons were some
7 longer in those industries that it perhaps wasn't as
8 accurate to use the ordinary antitrust measure in, for
9 example, pricing cases.

10 Q. More the short run?

11 A. Short run marginal costs, or a surrogate
12 short run having variable costs.

13 These concepts, as you may know,
14 were developed by my teacher actually, Professor
15 Rita (ph. sp.), in the 1970s, and adopted by
16 virtually every court now on the federal level in
17 antitrust pricing case.

18 But to look to the industries which have
19 very much longer time horizons, the Seventh Circuit
20 was the first one to adopt this in the MCI/AT&T case
21 when it said, well, that's the right measure, because
22 what we really want to look at is whether people are
23 covering the cost of production of the good or
24 service. That's really all you are looking to.
25 That's what incremental cost means.

1 Q. Okay. So you're looking at the cost of
2 production of adding the next unit --

3 A. Exactly.

4 Q. -- which leads a significant amount of cost
5 uncovered --

6 A. Precisely.

7 Q. -- that a profitable firm would have to
8 cover in order to declare itself as having a profit at
9 the end of the year?

10 A. At some point you will have to get greater
11 value for your product, a higher price for your
12 product than simply the incremental cost or marginal
13 cost or average variable cost. The reason you look to
14 that as a proper measure is that that price is not
15 predatory. That price does not harm anyone.

16 It has two aspects to it. If you're
17 covering -- in this context that the Commissioners
18 have to deal with, if you're covering long-run
19 incremental costs, then something isn't being
20 predatorily priced. It isn't being priced below cost.
21 It isn't being priced by a utility or its unregulated
22 affiliate as a way of keeping competitors out. They
23 are getting the value out of it. That's the positive
24 way of looking at it.

25 The negative way of looking at is it that if

1 you have something being covered, then there is no
2 detriment to the firm. The firm is at least covering
3 what it costs to produce that additional unit of
4 service or good so you're not building it at a loss or
5 producing it at a loss or providing the service at a
6 loss. So from all of those perspectives, you enhance
7 competition and consumer welfare.

8 Q. The definition that you're using assumes
9 that all other costs are sum costs. It has nothing to
10 do with this next decision?

11 A. Over the short term they are.

12 Q. Yeah.

13 A. That's right.

14 Q. Now -- but in the Commission what we have
15 stated is that we want to cover -- we want to cover
16 the marginal cost, the cost of adding the next unit.
17 Then we want to cover -- we want to make a
18 contribution to the joint and common costs. Then we
19 want to -- we're willing to admit that the owners
20 deserve a reward.

21 A. And that is -- and that's why I sympathize
22 with what the Commissioners have to do in these
23 situations because, as I said at the very beginning,
24 an antitrust lawyer would look at price and the effect
25 of all of this on price.

1 Let's say, for example, you do what you've
2 just suggested in your hypothetical. You wish the
3 utility to price 10 percent above its incremental cost
4 so that there is a contribution to overhead so that
5 the ratepayers can capture that. The result is the
6 price in the marketplace is 10 percent higher. So the
7 prices always go someplace, is the only point I'm
8 making. This Commission then has to decide, do you
9 want to shift this price higher in the market place
10 than it might otherwise have been to consumers because
11 you wish to have a higher return to the ratepayer?

12 Now, there is no one that I can tell you how
13 to do that.

14 Q. Right.

15 A. The only thing I wanted to explain is that
16 that is what really goes on, and that we don't have
17 what the OPC and the Commission Staff people were
18 suggesting, almost a free good.

19 Q. Well, I would like to defend what they're
20 doing because there is a natural bias in the
21 regulatory environment that has been developed over
22 the years, and I'm sure you're aware of that. That's
23 probably why you're here, to shed light on this bias.

24 But there is a bias that says, we want to
25 ensure that we maximize the benefit to the ratepayers,

1 and that's why we have this asynchronis (sic) pricing
2 thing that's been bouncing around in this room all
3 day.

4 A. I understand. Yes.

5 Q. What you're telling us -- or you're asking
6 us to do is to sort of abandon this bias that's just
7 out there. Am I right?

8 A. I would say two alternative things. One is,
9 yes, you can abandon the bias because you simply have
10 to recognize that, and this was very clear in the
11 economist witness testimony, because at times he was
12 telling you, really, it isn't right for the affiliate
13 to sell this product at a low price because the
14 ratepayers aren't making enough money. But it is a
15 very odd system to say, okay, well, then, we'll just
16 make them raise prices to consumers.

17 The fact is that that is one thing you could
18 do. You could say, look, we simply aren't in a
19 position to choose between ratepayers and consumers,
20 and that's what's going to happen. If we raise prices
21 to one, we lower prices to the other.

22 The other thing you could say, however, the
23 second part, is, it's not necessary -- it isn't to me
24 necessary to choose between those two. The other way
25 to maximize benefits to ratepayers is to provide an

1 effectively workable competitive process and
2 competitive environment because even though looking at
3 solely one utility, KCP&L, for example, or any of the
4 others, and saying that, well, we're just going to
5 allow incremental costs or something as our guide
6 here, or maybe a little higher, as we talked about a
7 second ago, with a more fully distributed cost
8 reasonable definition, but if we set up reasonable
9 cross-subsidization rules and allow a reasonable
10 operation of competitive affiliates and other
11 companies to come in, then that entire process should
12 end up maximizing benefits to ratepayers.

13 So I think if you look at it a little
14 broadly, you don't have to answer the question in the
15 way it was first placed.

16 Q. As a substitute for fully distributed or
17 fully allocated costs which includes all kinds of
18 things that no longer have any real impact on the
19 decision that the producer has to make?

20 A. Yes.

21 Q. What's wrong with using the long-run
22 incremental cost plus a contribution to joint and
23 common costs which this Commission in the past has set
24 at being something not very large?

25 Now, mind you, before you answer that

1 question, I recognize that we don't want our Staff in
2 the companies running how they do everything, but we
3 do want them to be able to come back and tell us what
4 they are doing by having standards, and this would be
5 a standard.

6 A. That is, in my view, a value choice.

7 Q. Okay.

8 A. That is -- that's not an economic analysis.
9 I can tell you that if you set it to what I consider
10 really an unreasonable level, unreasonable being a
11 fully allocated cost level where you're demanding
12 extremely high price, you're going to get less
13 production of the good or service. You're going to
14 get a misallocation of resources in society. You are
15 going to make consumers and ratepayers badly off.

16 As you move from long-run incremental costs
17 to adding something under the fully distributed cost
18 definition, you're clearly raising the price
19 somewhere, injuring consumers benefitting ratepayers.
20 That mix is something that the Commission will have to
21 decide.

22 Q. But you're saying we are injuring consumers.

23 A. Yes. You are re--

24 Q. We may be injuring their left pocket, but
25 we're rewarding their right pocket?

1 A. If all ratepayers are equal to consumers,
2 that's right.

3 Q. Right.

4 A. But some of the services purchased by a
5 nonregulated affiliate, for example, might not be
6 ratepayers of the particular utility. So I don't
7 think you will find an identity of ratepayers and
8 consumers.

9 Q. Sure. But that was just an extrapolated
10 example.

11 In my question to the Staff witness, if the
12 local electric company's appliance installation garage
13 uses power from that utility and charges that utility
14 less than the real cost of that power, but yet charged
15 the competitor down the street the real price, or a
16 higher price, is that fair? Who's gaining a value
17 from that?

18 A. No. I think what you would want to allow is
19 for the use of these cost allocation rules. You
20 should be able to determine, as you discussed before,
21 that the price of any particular service that the
22 utility is selling to the unregulated affiliate is
23 going to be at a marginal cost level or incremental
24 cost level, or whatever higher level you decide to
25 choose. And then, presumably, that same price you

1 would be able to determine if others were to purchase
2 it would be at the same price. That would not cause
3 any problems.

4 What you're trying to prevent by the cost of
5 the subsidization, the focus of the cost allocation
6 rules, is exactly that, and that seems to me is all
7 you need to do, which is why I stressed that in the
8 prepared remarks summary I made.

9 Many of these other kinds of restrictions
10 are really unnecessary to where this state is and
11 where this Commission is in trying just to look at
12 affiliate transaction. That's the name of the
13 electric utility rule that is proposed.

14 COMMISSIONER CRUMPTON: Right. Thank you.

15 JUDGE THORNBURG: Commissioner Murray?

16 COMMISSIONER MURRAY: Thank you.

17 QUESTIONS BY COMMISSIONER MURRAY:

18 Q. Good afternoon.

19 A. Good afternoon.

20 Q. I just have one, possibly two questions.

21 In your opinion, do we need to be adopting
22 an affiliate transaction rule, or are there sufficient
23 protections under current law?

24 A. It doesn't appear to me, not knowing as much
25 about the Commission procedures and the rules, that

1 you have cost allocation mechanisms, procedures, in
2 place that are regular and well enough understood.
3 And that's really as much as you need. I think that's
4 as far as you need. So to the extent you don't have
5 those, that's what the affiliate transactions will --
6 properly should be limited to.

7 The focus should be in cross-subsidization.
8 The way you control cross-subsidization is by good,
9 well understood, well structured and well documented
10 cost allocation rules. After that, all of these other
11 restrictions seem to be completely surplus and
12 unnecessary.

13 COMMISSIONER MURRAY: Okay. Thank you.

14 That's all I have.

15 MR. MAHINKA: Thank you very much.

16 JUDGE THORNBURG: Excuse me, Mr. Mahinka. I
17 might have one question.

18 QUESTIONS BY JUDGE THORNBURG:

19 Q. I'm trying to get this distinction between
20 consumers and ratepayers. Should the ratepayers be
21 treated at least as well as consumers. Are they also
22 consumers?

23 A. Well, I think we discussed that before.
24 There is not going to be a complete identity between
25 the ratepayers of the particular utility and the

1 consumers of all of the item. That will occur in
2 some -- with some people, but it is not 100 percent
3 identity. So, no, you won't find that as a factual
4 matter.

5 Second, when you ask, should you treat them
6 as well, I mean, you answered the question. It's
7 really a value judgment. My only point here is that
8 you cannot assume as some of the comments from the
9 Commission Staff economist and others sort of lead you
10 to believe that you can just raise one price and it
11 has no effect on the other.

12 In fact, if you raise prices for a product,
13 you're going to raise them to the consumers, the
14 buyers of that product. Some of those will be
15 ratepayers and some won't, but there is no
16 equivalency.

17 So, for example, ratepayers presumably have
18 already paid for the electricity, so they are not
19 getting disadvantage for the cost of the electricity
20 they are buying. You're really saying that somehow
21 they are being disadvantaged because there is an
22 insufficient contribution to the overhead of the
23 utility for which they later will have to pay
24 something.

25 Q. Well, rather than --

1 A. It is sort of indirect, so you have an
2 indirect detriment to the ratepayer, certainly, and
3 Commissioner Crumpton recognized that, but you have a
4 direct detriment to the buyer who does have to pay an
5 immediate higher price.

6 Now, how you value that and the split you
7 make between that is a value judgment that this
8 Commission presumably does. But I just want to point
9 out clearly that it is going to be a cost allocation
10 question.

11 Q. Rather than raising prices to consumers,
12 could you look at it from the standpoint of lowering
13 prices to ratepayers?

14 A. Well, you -- no, because, as I said, the --
15 I don't think anyone argues that if we -- if this
16 Commission -- the effect of the Commission rule is to
17 raise the price of an unregulated affiliate's service
18 that that additional increment of money is going to
19 lower the kilowatt hour price of a ratepayer
20 immediately. That's not going to happen. So, no, it
21 isn't going to work like that.

22 It's going to work at best as a direct
23 increment of cost to the purchaser from a higher price
24 that that purchaser has to pay. And then, second, it
25 will be an indirect reduction to the ratepayer of some

1 magnitude.

2 But the question you have to ask is really

3 if the direct price that the ratepayers is paying for

4 electricity is not going to be immediately affected,

5 what is the call that the ratepayer has on the

6 efficiency of the company? Is it supposed to share in

7 the profitability of the company? I mean, these are

8 very difficult questions for the Commission to wrestle

9 with.

10 But I would say that you have immediate harm

11 in the -- with -- in the context of the customer

12 prices raised and you have an indirect benefit to some

13 degree to ratepayers who are not going to be identical

14 with the consumer population.

15 JUDGE THORNBURG: Okay. Thank you.

16 MR. MAHINKA: Thank you.

17 JUDGE THORNBURG: At this point, we'll take

18 a short recess. Be back at ten after three. Thank

19 you.

20 (A recess was taken.)

21 JUDGE THORNBURG: We'll go back on the

22 record at this time.

23 And is there anyone that had a time

24 constraint that we could get you out in time by?

25 Okay.

1 MR. WILLIAMS: (Indicated.)
2 JUDGE THORNBURG: Yes?
3 MR. WILLIAMS: Yes. Judge Thornburg,
4 Johannes Williams with Edison Electric Institute.
5 If possible, immediately concluding the
6 presentation by the Ameren witnesses this afternoon,
7 there is a slim but diminishing possibility that if we
8 leave here by four, or thereabouts, we could make our
9 travel connections as well. We have a prepared
10 statement and a live witness that we would like to
11 testify and listen to the Commission's -- and respond
12 to the Commission's questions, of course.
13 JUDGE THORNBURG: Okay. For Ameren, was
14 your witness also trying to make connections?
15 MR. NIEHOFF: Dr. Landon can wait for the
16 remainder of the afternoon. Obviously, we would like
17 to make sure that he's available for the
18 Commissioners' questions if they would have any of
19 him.
20 JUDGE THORNBURG: I appreciate you being so
21 gracious on the part of your witness.
22 Before we go with Edison Electric Institute,
23 I need to ask Mr. Riggins to come up, and Commissioner
24 Drainer might have a question for you. And you were
25 here prior to the lunch break?

1 MR. RIGGINS: That's true.

2 COMMISSIONER DRAINER: I just wanted to
3 know, Mr. Riggins, whether you had any response to my
4 questions before the lunch break? I understand that
5 we're doing the attorneys with their witnesses as we
6 move along, so I was --

7 MR. RIGGINS: Yes, Commissioner. I'm
8 prepared to answer those questions, if you would like
9 me to do that now, or wait until the end.

10 COMMISSIONER DRAINER: Our Law Judge has
11 told me he would prefer that we have the attorneys
12 answer as they are -- as their witnesses finish up, so
13 if you could do that, I would appreciate it.

14 MR. RIGGINS: With regard to your first
15 questions on the fiscal impact statement, at the time
16 the proposed rules were presented to the Commission we
17 received a letter from the Commission Staff asking us
18 to attempt to quantify the impact on KCP&L, the fiscal
19 impact, of complying with the rules if they were
20 adopted as proposed.

21 And we responded to that by letter to Lena
22 Mantle, I believe, and indicated that there were
23 provisions of the rules that we believe, if they were
24 enacted, would cause increased costs for KCP&L, and we
25 identified those. But we also indicated that we

1 really didn't feel like we were able to quantify those
2 at the present time. So that was our response, and I
3 guess I really don't have anything to add to it at
4 this point.

5 COMMISSIONER DRAINER: Could you tell me
6 what those costs were?

7 MR. RIGGINS: They were primarily in the --

8 COMMISSIONER DRAINER: I mean, the dollar
9 amount?

10 MR. RIGGINS: -- in the record-keeping
11 requirement and with the requirement that in some
12 cases the Company might have to develop in some
13 instances three different costs for a given product or
14 services, might have to ascertain market pricing. We
15 might have to ascertain the fully distributed cost of
16 the utility to provide the service for itself if it
17 was going to provide that service.

18 So it was basically in the area of
19 developing costs information for -- that we wouldn't
20 ordinarily develop for increased record-keeping
21 requirements that we feel we don't need to do for
22 business purposes, but we would need to do to comply
23 with the rule.

24 COMMISSIONER DRAINER: Could you tell me
25 what the dollar amount was?

1 MR. RIGGINS: No. We didn't -- as I said,
2 we didn't feel like we were in a position to give a
3 specific dollar amount.

4 COMMISSIONER DRAINER: Oh, I'm sorry. I
5 misunderstood. I thought you said you had --

6 MR. RIGGINS: No. I'm sorry. I said we
7 couldn't.

8 COMMISSIONER DRAINER: Okay. I appreciate
9 that.

10 MR. RIGGINS: Okay. With regard to the
11 second issue on the variance, we support the idea of a
12 variance provision in the rule, with regard to the
13 idea that the variance provision would be available to
14 individual companies to come in and request a variance
15 from all or some portion of the rule. We would have
16 no objection to the rule being -- the variance
17 provision in the rule being clarified in that respect.

18 COMMISSIONER DRAINER: Okay. Thank you.
19 I greatly appreciate your answers.

20 MR. RIGGINS: Thank you.

21 JUDGE THORNBURG: Okay. I think that we're
22 going to call on Mr. Williams. And do you have any
23 brief statements you want to offer at this point? And
24 also this would be the ideal time to address
25 Commissioner Drainer's questions.

1 MR. WILLIAMS: Thank you, Judge Thornburg.

2 Johannes Williams for EEI.

3 With respect to the cost of compliance
4 question, Commissioner Drainer, we are obviously going
5 to defer to our members' much more nuts and bolts and
6 hands-on information and knowledge with respect to
7 that question.

8 On the variance question, we believe that it
9 would be an important tool for the Commission to have
10 available; however, it's more important in this
11 instance to get the rules right in the first instance,
12 and that's why we look forward to the opportunity to
13 presenting oral testimony to you here in a moment and
14 addressing what the content of the Commission's rules
15 should be.

16 Preliminarily, I'd like to request, Judge
17 Thornburg, that I could give you a copy of the NARUC
18 resolution regarding cost allegation guidelines for
19 the energy industry which OPC witness -- pardon me,
20 please -- Dittmer referred to earlier with respect to
21 the Commission's endorsement of asymmetric pricing.

22 The content of this resolution in the
23 seventh and eighth "whereas" clauses is particularly
24 significant regarding the weight of those cost
25 allocation guidelines should be reported by this

1 Commission. They are to provide guidance and not
2 intended to be rules or regulations prescribing how
3 cost allegations and affiliate transactions are to be
4 handled in recognition of unique situations and
5 circumstances in each particular state.

6 I'd like to submit this to you, please.

7 JUDGE THORNBURG: That would be fine. If
8 you could hand a copy to the court reporter, she can
9 give that the next-numbered exhibit number.

10 MR. WILLIAMS: Okay. Thank you.

11 JUDGE THORNBURG: And I think some of the
12 written comments referred to those same -- is it a
13 resolution or --

14 MR. WILLIAMS: Yes. It's the NARUC
15 resolution passed on July 23 this year.

16 JUDGE THORNBURG: There is some comments
17 referred to those, or there is some indication those
18 are already in the record, and we'll just add these.

19 MR. WILLIAMS: Thank you.

20 (EXHIBIT NOS. 3 AND 4 WERE MARKED FOR
21 IDENTIFICATION.)

22 MR. WILLIAMS: The second matter, Judge
23 Thornburg, is that prior to calling Dr. Mathew J.
24 Morey, Edison Electric Institute, in the same sense as
25 the presentation by Kansas City Power & Light, has

1 supplemental written testimony to compliment the oral
2 testimony that Dr. Morey is about to give, and I'd
3 like to present that to you at this time.

4 JUDGE THORNBURG: That would be acceptable.

5 MS. SHEMWELL: Judge, could I be heard,
6 please?

7 JUDGE THORNBURG: Yes. Does it concern
8 this?

9 MS. SHEMWELL: Staff is not actually
10 entering objections because they feel that the
11 Commission should have the full information, but when
12 people bring in full written testimony at this point,
13 the Commission has not had the opportunity to read it
14 prior to the hearing. With the comments, you've had
15 the opportunity to read all of the comments and when a
16 witness gets up, they can respond. But this denies
17 witnesses the opportunity to read it and perhaps
18 respond in their comments.

19 So in some respects, in terms of just
20 fairness, this makes it very difficult for us to cover
21 all of the items that they may cover. You know, a
22 synopsis is one thing, the testimony that you're going
23 to follow along, but when you're giving written
24 testimony, again, that nobody has had the opportunity
25 to view ahead of time, we can't respond. So, in

1 essence, you're allowing another round of comments.

2 JUDGE THORNBURG: Would you prefer this
3 statement be read into the record today?

4 MS. SHEMWELL: Actually, what I would have
5 preferred is that it come in with the second -- with
6 the reply comments so that people could have read it
7 at that time.

8 Obviously, in the interest of time today,
9 I'm not going to ask it be read into the record, but
10 as a matter of fairness, it should have come in with
11 reply comments so everybody can read it.

12 JUDGE THORNBURG: I understand that, and
13 that's a good point.

14 We'll go ahead and accept it today, and I'm
15 not going to ask the witness to read the entire
16 statement in. Thank you.

17 MR. WILLIAMS: Judge Thornburg, the
18 rationale for submitting the written testimony here is
19 in the nature of what the witness would testify to;
20 however, given the questions that we've already heard
21 from the Commission today, the oral can be more
22 responsive to the questions that the Commission has
23 already raised, and we'd like to submit this as if we
24 were to have gone first and didn't have the chance to
25 have heard the Commission questions.

1 JUDGE THORNBURG: Thank you.

2 MR. WILLIAMS: Edison Electric Institute

3 would like to invite Dr. Mathew J. Morey to the stand.

4 JUDGE THORNBURG: Dr. Morey, would you raise

5 your right hand, please?

6 (Witness sworn.)

7 JUDGE THORNBURG: I'd ask that you briefly

8 introduce yourself, and we'll take your prepared

9 comments, and then we'll have some questions for you.

10 Thank you.

11 DR. MOREY: Thank you, Judge Thornburg.

12 Good afternoon. Thank you, Commissioners,

13 for giving EEI and me the opportunity to speak to you

14 about these issues today.

15 I am Mat Morey. I am the Director of

16 Economics of the Edison Electric Institute, and in

17 that capacity I supervise the development of EEI's

18 economic positions and policies affecting the electric

19 utility industry and have participated -- as I bring

20 into this proceeding, I have participated in a number

21 of state proceedings which deal with much of the same

22 set of issues that you're addressing here today.

23 To make my summary statement as brief as

24 possible in the interest of time, our concerns as

25 expressed in our earlier comments on the proposed

1 Staff rule and expressed today and in comments I've
2 made before the Commission Staff a year or so ago,
3 most of those concerns focus on the issues of cross-
4 subsidy and the transfer pricing rules and the
5 preferential treatment standards that have been
6 proposed in this rule.

7 And our concerns run as deeply as those as
8 Mr. Mahinka and, I expect, as deeply as those of
9 Dr. Landon who will precede -- who follows me on the
10 stand here today.

11 Even as Missouri considers this rule, before
12 it decides to allow customer choice, even before it
13 allows to decide customer choice for retail markets,
14 the citizen of Missouri, I think, find themselves at a
15 turning point here in this proceeding. At issue, I
16 think, before the Commission are really the proposed
17 regulations that really govern both the current and
18 future relationships between the utility and its
19 affiliates, and these rules, I think, will determine
20 whether or not Missouri citizens will enjoy the real
21 and full benefits of competitive markets.

22 I think it is probably premature to advance
23 a rule as complicated as this one, as Mr. Mahinka has
24 so eloquently pointed out. The primary concern of
25 this Commission should be on the protection of

1 ratepayers from unwittingly engaging in cross-
2 subsidization through the utility and the rates they
3 pay of its affiliates.

4 I think that the rules themselves will
5 ultimately determine whether Missouri's electric
6 ratepayers are able to continue as they have in the
7 past, continue to benefit from economies of scale and
8 scope. These are economies of scale and scope that
9 they have benefited from as a result of years of
10 managerial experience and practice and have produced.

11 I think when the Commission sits down to
12 consider this rule, in addition to considering the
13 protection that it must afford utility ratepayers from
14 cross-subsidy, that it must consider the fact that the
15 transaction between the utility and the affiliate is a
16 two-sided -- as all transactions are, as it goes
17 without saying -- it is a two-sided transaction, and
18 there are benefits that flow to the ratepayers as a
19 result of encouraging transactions which make full use
20 of the utilities' and the affiliates' resources. This
21 is, in effect, a capture of the economies of scope and
22 scale, as we have commented in our reply and earlier
23 comments.

24 I am deeply concerned that by handicapping
25 the utility and its affiliate through the proposed

1 Staff rule and the transfer pricing provisions in it
2 and the affiliate, in particular, as it enters into
3 competitive markets, the draft rules will relieve
4 competitors of the utility affiliate from having to
5 improve their products and services and lower their
6 costs to retain existing customers and to win new
7 ones.

8 Frequently, these competitors, as you will
9 discover if you open up your retail markets at some
10 time here in the future, are very large corporations.
11 They are based outside of Missouri. They have
12 bountiful resources. They've got a lot of market
13 savvy, and they have tremendous advantages that could
14 easily match any of those at the local utilities and
15 their affiliates, advantages that I think probably
16 would easily match those that the affiliate has by
17 virtue of its corporate proximity to the incumbent
18 utility.

19 The efficient competitors -- as we have seen
20 in many other states, the efficient competitors will
21 not be harmed by having to compete with the economies
22 of scope that vertical integration and coordination
23 would bestow upon a utility affiliate and, thereby,
24 through that mechanism lower the cost profile of that
25 affiliate.

1 By definition, the efficient competitors
2 will bring their own offsetting advantages. Not all
3 competitors are equal in what they bring to the
4 market. There is no reason in a competitive market
5 why we would need to level that by raising the costs
6 of one particular competitor, as Mr. Mahinka has so
7 eloquently pointed out. There is no reason to raise
8 those costs in order to make the playing field level.

9 By the same token, there is really no
10 certainty that the affiliate would succeed even if it
11 is granted the chance to leverage the legitimate
12 economies that it may have access to in terms of
13 vertical coordination of the utility.

14 I think the -- I believe that the Commission
15 needs to work very hard not to confuse -- as I think
16 some of the witnesses here have done, to confuse
17 legitimate competitive advantage that enures any
18 vertically coordinated firm with unfair advantages
19 that emerge from undue preferences and from cost
20 subsidies.

21 I'm going to have to keep in mind that the
22 definition of "cross-subsidy" here which has not been
23 stated explicitly from -- in any of the discussions
24 I've heard so far, so long as the price set for the
25 transaction between the utility and the affiliate did

1 not fall below incremental cost, and we can debate
2 about whether we're talking short-run incremental cost
3 or long-run incremental cost as the appropriate
4 definition here, so long as that price did not fall
5 below incremental cost, there would be no cross-
6 subsidy. That is generally the definition of
7 "cross-subsidy" used in the economics literature.

8 That's not to say that the price that would
9 be set for the transaction should be at incremental
10 cost, for as we've discussed or heard discussed by
11 other witnesses, there may not be a sufficient
12 contribution to fixed cost or common cost recovery,
13 but the determination of what that contribution will
14 be in a transaction between the utility and the
15 affiliate will be determined by other factors
16 exogenous to this transaction, namely the market
17 price, the cost of self-provision, basically, what the
18 opportunity costs will be to the affiliate or the
19 opportunity costs to the utility if the transaction is
20 flowing in the opposite direction.

21 So we would urge you not to make some
22 confusion here or conflate the issue of competitive
23 advantage as it was used in economies of scope and
24 scale with undue preferences and unfair advantages
25 that really have more to do with the use of essential

1 facilities, the wires company, which is not really at
2 stake here in this rulemaking.

3 The markets that these affiliates -- at
4 least at this point in time, the markets that these
5 affiliates are seeking to enter, or have already
6 entered, are already competitive. They are entrants.
7 They are not incumbents.

8 And so the rules that I think you're
9 considering go far and away beyond what is sufficient
10 to protect ratepayers against cross-subsidization and
11 in so doing they prohibit or discourage efficient
12 transactions that would benefit ratepayers.

13 The appropriate transfer pricing rule, I
14 think, one which treats the transaction symmetrically
15 will be the most appropriate rule to apply in this
16 case and really is the only one that you need to focus
17 on in this rulemaking.

18 Let's take, for example, a utility had a
19 payroll services department that could offer payroll
20 services to one of its affiliates. It's got a fixed
21 cost associated with that payroll services facility or
22 system, and there is some excess capacity in that
23 payroll system. They could offer to provide payroll
24 services at some incremental cost to an affiliate.

25 The decision the affiliate will make to buy

1 or purchase that payroll service will depend on the
2 relationship of the incremental cost. I suppose they
3 could offer it at incremental cost, and that cost is
4 going to be compared to the stand-alone or the self-
5 provision cost for the affiliate to provide that
6 payroll service itself, or to provide the service by
7 going out in the market and buying it from a third
8 party.

9 If the fully distributed cost of the payroll
10 service is above the market price for provision by a
11 third party, and both of those are above the
12 incremental cost of providing the service, if the rule
13 as proposed by Staff were applied, the transaction
14 would not take place between the utility and the
15 affiliate. If the incremental price or cost is below
16 FDC and market, and FDC is above the market, and the
17 rule says it must be at FDC, the affiliate would have
18 no interest whatsoever in purchasing payroll services
19 from the utility.

20 If the affiliate had the payroll service
21 department and had the excess capacity, and the prices
22 were -- or costs and prices were in the same relation,
23 and it could offer that to the utility, it turns out
24 the -- under the Staff rule, the transaction would
25 take place.

1 Now, it turns out with the same set of cost
2 conditions and opportunity costs associated with the
3 transaction, the transaction with the same set of
4 benefits that could be shared between the utility and
5 the ratepayers could very well be treated differently.

6 I don't understand a rule that would somehow
7 treat a transaction which has the same set of benefits
8 no matter what direction would treat it differently,
9 other than there is some general bias built into that
10 against allowing the affiliate to share in those
11 economies.

12 If that bias is somehow designed to protect
13 competitors, then I think the emphasis is misplaced
14 because the emphasis should be on, number one,
15 protecting ratepayers, and, number two, simply
16 protecting competition, as Mr. Mahinka has pointed
17 out.

18 So as I see it, the Staff rule suffers from
19 this one major flaw which is that it tends to treat
20 the benefits of a transaction differently depending on
21 the flow of that transaction.

22 A rule which treats those things
23 symmetrically, or comes as close as it can to treating
24 them symmetrically, I think, offers greater benefits
25 and a more likely chance that ratepayers will, in

1 fact, benefit from a utility-to-affiliate sale of
2 goods and services.

3 So in that respect the Staff rule is likely
4 to distort what I would consider beneficial resource
5 sharing decisions, and it distorts them in a way that
6 simply does not benefit the ratepayer in the way that
7 the Commission has always sought to benefit the
8 ratepayer as -- through efficient use of utility
9 resources. This has been a traditional pillar of the
10 Commission's approach to regulation which is to ensure
11 that the utilities' resources are used as efficiently
12 and fully as they can be.

13 I think a policy that produced such
14 asymmetries in the treatment of the transaction is
15 really bound to create inefficient outcomes because,
16 first of all, the affiliate serving the competitive
17 market would never pay a utility more than a market
18 price for the good or service. There seems to be a
19 presumption here that you could compel the transaction
20 to take place at a price which was simply
21 uneconomical.

22 Even though ratepayers of the utility could
23 still benefit from the transaction that recovers less
24 than fully distributed costs, somewhere between
25 incremental, say, and FDC, the transaction simply

1 would not be completed, so I guess ratepayers would be
2 foreclosed from benefiting in that case.

3 To support the rule I think that there are a
4 number of things that the Commission already has been
5 practicing that would ensure that they can scrutinize
6 closely these types of transactions in a reasonable
7 manner.

8 And I think the Commission already has the
9 authority to require commission of costs and other
10 supporting data. The alternative rules provide that
11 kind of mechanism, as well as for the maintenance of
12 cost allocation manuals or other supporting documents
13 which would give the Commission, I think, as it
14 already has at its disposal, additional mechanisms by
15 which it could ensure that cross-subsidization and
16 undue preference has not been shown.

17 This state is not alone in considering these
18 rules or these types of rules. There are at least
19 24 out of 40 states that we've managed to survey
20 within the last several months that have put in place
21 rules governing pricing of affiliate transactions. It
22 turns out that a majority of those who have rules in
23 place have not elected a blanket asymmetric pricing
24 rule that -- like the type you're considering in this
25 state.

1 There are a variety of approaches that have
2 been taken. A few of those -- and I won't elaborate
3 on all of the details. We would be happy to provide
4 you with additional information about this, but there
5 were only about eight of these 24, about 33 percent,
6 that have adopted an asymmetric pricing rule.

7 There are about seven commissions that have
8 decided that they need to go on a case-by-case or
9 corporation-by- corporation basis, and really have no
10 blanket rule in place to apply.

11 And six commissions, about 25 percent, use
12 multiple methods as they apply to particular types of
13 transactions, so there are groups or categories of
14 transactions to which a particular pricing rule has
15 been applied.

16 And there are three commissions that use the
17 prevailing market price as a standard for judging the
18 reasonableness of the transaction.

19 There is at least one state that actually
20 uses incremental cost as a standard. I believe that's
21 Minnesota, for certain types of transactions.

22 The survey that we've done actually finds a
23 number of other products and services in the other
24 direction also of being treated in a wide variety of
25 ways, and I think that while there are some states

1 that have chosen asymmetric pricing as proposed
2 similar -- similar to those rules as proposed here in
3 this state, there are a number of states that have
4 chosen to go a different directions.

5 And I think while that doesn't give you any
6 strong justification to pick one approach or another,
7 I think it is indication that at least there are some
8 considerations that have been given to the efficiency
9 as well as the equity issues that lie before you here
10 and have been -- conclusions have been drawn which are
11 markedly different than what the Staff and OPC would
12 propose here today.

13 With that, I think I will thank you for your
14 patience. I conclude my statement. You can read the
15 written remarks at your leisure.

16 I would be happy to entertain any questions.

17 JUDGE THORNBURG: Commissioner Drainer?

18 COMMISSIONER DRAINER: I have no questions
19 but thank you very much for your remarks.

20 JUDGE THORNBURG: Commissioner Murray?

21 COMMISSIONER MURRAY: Just very briefly.

22 QUESTIONS BY COMMISSIONER MURRAY:

23 Q. Do I understand that you think that there
24 may be a need for a rule at the present time but that
25 it should be limited to focus on cost allocation and

1 look at preferably incremental costs; is that --
2 A. Well, I think that the Commission's
3 attention should be focused on the issue of cross-
4 subsidization and ensuring that there is no cross-
5 subsidization, but I think with regard to the rule one
6 can consider a focus on a rule which allows pricing to
7 take place in what I would refer to as a zone of
8 reasonableness or a subsidy-free zone. A price
9 anywhere between incremental and market or incremental
10 and fully distributed cost is sufficient to protect
11 ratepayers against cross-subsidy.

12 I think there is very little dispute here
13 among the economists in this room and those that have
14 come before about that point. I think it's -- it's a
15 question of whether or not a price below fully
16 distributed cost or below the market would somehow
17 provide an unfair advantage to an affiliate in a
18 competitive market where that by virtue of that price
19 lowers the cost profile of the affiliate, and,
20 therefore, makes it more competitive in those markets.

21 Q. An advantage to an affiliate is not
22 necessarily unfair?

23 A. It is not necessarily unfair. Every
24 competitor brings their own advantages and they are
25 all different.

1 COMMISSIONER MURRAY: Okay. I don't think I
2 have anything else. Thank you.

3 DR. MOREY: Thank you.

4 JUDGE THORNBURG: Any follow-up,
5 Commissioner Drainer?

6 COMMISSIONER DRAINER: No.

7 JUDGE THORNBURG: I had one question, just
8 to educate me a little bit.

9 QUESTIONS BY JUDGE THORNBURG:

10 Q. The long-term incremental cost, does that
11 begin to approach fully distributed cost because it
12 takes into account some of the incremental costs? Is
13 there a difference?

14 A. Well, there is -- technically speaking,
15 there is a difference between long-run incremental
16 costs and fully distributed costs. I think in
17 listening to the discussion that Mr. Mahinka had
18 earlier about this issue that I think his suggestion
19 is that fully distributed cost could be used as an
20 approximation for long-run incremental costs.

21 The definition of "long-run incremental
22 cost," again, depends on your definition of "long
23 run." If we're talking about a long run in which all
24 costs are variable, so we're talking about capital
25 replacement and things of that nature, then a fully

1 distributed cost could very well be a reasonable
2 approximation.

3 But in some instances, because of
4 technological change, and I can think of the computer
5 and telephone industry as an example of that, the
6 long-run incremental cost may very well be below the
7 fully distributed cost, significantly below the fully
8 distributed cost.

9 So I think it's difficult to say universally
10 or to establish a principle that we could live by in
11 which we could say long-run incremental price is
12 effectively approximated by fully distributed cost in
13 all cases. We would have to be a little bit more
14 cautious about that.

15 JUDGE THORNBURG: Thank you.

16 Mr. Williams, did you have any other
17 witnesses or comments today?

18 MR. NIEHOFF: They did not. They are
19 rushing for their airplane.

20 JUDGE THORNBURG: You did not have any other
21 witnesses or comments?

22 MR. WILLIAMS: No, sir. I'm sorry. Excuse
23 me. Thank you very much, Judge Thornburg.

24 COMMISSIONER DRAINER: Drive careful.

25 JUDGE THORNBURG: We'll continue now, and

1 I'm going to go back and pick up AmerenUE.
2 Mr. Fagan, thank you for your patience
3 today.
4 MR. FAGAN: Our pleasure.
5 MR. NIEHOFF: Thank you for yours as well.
6 JUDGE THORNBURG: Do you have any opening
7 statements or remarks?
8 MR. FAGAN: Very quick.
9 Just for the record, my name is Shawn Fagan.
10 I'm on behalf of Ameren and AmerenUE. I will be very
11 quick.
12 Commissioner Drainer, we can certainly
13 answer your questions right now before Dr. Landon
14 testifies.
15 COMMISSIONER DRAINER: Thank you.
16 MR. FAGAN: Mr. Niehoff will address the
17 cost question, and I can address the variance
18 question. What we prefer to do, if it would be all
19 right with you, is I can address the variance question
20 quickly now, and then after Dr. Landon testifies,
21 Mr. Niehoff will address the fixed cost question, or
22 the -- I'm sorry -- the cost incremental question.
23 COMMISSIONER DRAINER: Okay. Can you just
24 give me both?
25 MR. FAGAN: I actually -- I don't know

1 enough about the fixed cost to speak about it or the
2 cost --

3 COMMISSIONER DRAINER: Okay. Great.

4 MR. FAGAN: With respect to the variance, we
5 agree that a variance provision makes a lot of sense.
6 Ameren also has no problem with a variance being
7 granted on a corporation-by-corporation basis.

8 That said, we want to emphasize that we
9 believe that use of a variance in the way that a lot
10 of the parties have proposed today is sort of a
11 second-best option, and that if it's readily apparent
12 that there are going to be problems with the current
13 rule, such that a variance is an absolute necessity in
14 certain recognized circumstances, it probably would
15 make sense to redraft the rule to address those
16 circumstances rather than to rely upon a variance and
17 move forward with a rule already recognized as flawed.

18 That said, I'll call Dr. Landon to the
19 stand.

20 I have a handout that we've prepared. It is
21 not new material. It is a summary of things in our
22 brief. And, really, it is -- may I approach the
23 Bench?

24 JUDGE THORNBURG: Yes, you may.

25 (EXHIBIT NO. 5 WAS MARKED FOR

1 IDENTIFICATION.)

2 MR. FAGAN: You'll see the -- I'll just give
3 you a brief description of what's in here.

4 The first page is a quick outline and
5 summary of what Dr. Landon will be talking about. The
6 second page is a quick outline and summary of our
7 comments with respect to the different types of rules
8 proposed by the Staff.

9 And then something that we thought might be
10 helpful is, as you go through, the cross-subsidization
11 rules proposed by the Staff are set forth in contrast
12 to the rules proposed by Ameren, and this allows a
13 sort of easy comparison, and then the same thing is
14 done with the anti-discrimination rules and, once
15 again, with the Proposed Rule 3.

16 So, hopefully, you will find them useful,
17 and we do have plenty of copies for everyone in the
18 hearing room who needs it.

19 With that, I'll let Dr. Landon take the
20 stand.

21 (Witness sworn.)

22 JUDGE THORNBURG: And as with the other
23 witnesses, if you will introduce yourself and tell us
24 just a little bit about yourself, and then we'll take
25 your prepared comments and testimony.

1 DR. LANDON: My name is John, middle initial
2 H, Landon, L-a-n-d-o-n. I'm a principal and director
3 of the electric utility and telecommunications
4 practice for a firm called Analysis Group Economics.
5 Our firm is headquartered in Cambridge. My office
6 happens to be in San Francisco.

7 I've been working with regulated utilities
8 as a consultant for about 22 years. Before that I
9 spent 12 years teaching at two universities economics,
10 including economics of regulation.

11 I want to thank you very much for holding
12 this proceeding to give me the opportunity to come,
13 and I want to thank my client for giving me the
14 opportunity to participate in it.

15 I find the issues that we're engaged in here
16 to be quite interesting, and I think they are
17 inordinately important in terms of getting it right in
18 terms of setting the background for providing greater
19 consumer welfare rather than restricting consumer
20 welfare. And with your indulgence, I would like to go
21 to the easel behind me and use that as an illustrative
22 aid in talking about some of the issues that I think
23 are central to our concerns today.

24 As several of the economists have said in
25 the course of their discussions with you, the thing

1 that we really ought to be focused on is consumer
2 welfare. This is not a case of what competitors
3 should be given advantages in order to allow them to
4 enter the market. It isn't a case of trying to
5 maximize the number of mom and pop electric companies
6 in the country. This isn't a case of trying to find
7 all of the ways we can handicap the incumbent in order
8 to advantage some other parties in the industry.

9 What we're hopefully engaged in is setting
10 up a set of rules and principles that will maximize
11 consumer welfare. And what maximizing consumer
12 welfare means is allowing the production of the good
13 or service, in this case electricity and related
14 services, to be done at the lowest possible prices, at
15 the highest reasonable quality, and to allow customers
16 to have many choices between alternative providers and
17 alternative packages of products and services.

18 To the extent that we're successful at
19 maximizing consumer welfare in this way, we would have
20 done our job well. And consumer welfare, as was
21 indicated in some previous testimony today, includes
22 both consumers who are specifically regulated
23 consumers of the incumbent utility as well as
24 consumers who are consumers more generally in the
25 energy market who will also be major stakeholders in

1 the outcome of what decisions we make in this docket.

2 The thing we want to do and that we must do
3 in order to provide fair and open and a reasonably
4 level playing field for competition in the industry is
5 to prevent illegitimate advantage to keep incumbent
6 utilities from doing things that will have the
7 significant effect of preventing competition from
8 occurring.

9 The concerns that we ought to have are with
10 cross-subsidization, which basically would be the
11 imposition of costs on regulated ratepayers to allow
12 the subsidization of unregulated affiliates. This
13 would be both unfair and anticompetitive in the sense
14 of reducing consumer welfare.

15 Secondly, we should be considered with
16 discrimination of the access to essential services.
17 The unregulated affiliates ought to be in the same
18 position as regulated affiliates with respect to the
19 access to a facility.

20 Similarly, there is some information that is
21 required in order to be a competitor in the industry,
22 and access to essential information, likewise, should
23 be nondiscriminatory. It should be equally available
24 to nonaffiliated as it is to affiliated entities.
25 Once we've taken care of this, when we've really

1 satisfied our obligations in terms of making sure the
2 playing field is level and that there are no undue
3 anticompetitive effects as a consequence of our moving
4 forward and letting the incumbents participate in the
5 market.

6 We want to preserve the benefits, the
7 legitimate advantages of the incumbents in the market.
8 And we want to do that not just because we want the
9 incumbents to be able to offer their products and
10 services at a lower price, we want to do that because
11 we want to make this a competitive industry. We want
12 to goad other suppliers into bringing their
13 competitive advantages to the floor as well. It is
14 only in the competition of entities who have various
15 sets of advantages and disadvantages that we find out
16 what the most efficient combinations of goods and
17 services are and find out what the form of the most
18 efficient firm is.

19 Every party that wants to come into the
20 electric market in this state or any other state will
21 bring to the market some advantages that are unique
22 and distinct to it as opposed to other competitors.
23 Some have global reach in terms of being major players
24 in global energy market places.

25 Others have significant investments in other

1 related industries. Others have worldwide experience
2 in competitive markets around the world. Others have
3 financial advantages in being larger and better
4 capitalized companies with lower cost of capital.
5 Others have unique intellectual advantages in having
6 great depth of experience in terms of being able to
7 undertake complex calculations of risk and hedging in
8 complex futures markets for services.

9 The people that come into these markets will
10 all have advantages, and so the idea is not to strip
11 these advantages out even from the incumbent or for
12 others, the idea is to invite everyone who wants to
13 come into the market to come in with whatever their
14 legitimate advantages are and let them compete on the
15 merits, and that competition is what will produce low
16 prices, high quality products, and a good range of
17 services available.

18 In order to do this, you've got to let the
19 incumbent keep the legitimate economies of scale and
20 scope that they have so they can compete with other
21 parties who will bring their scale and scope
22 economies. You cannot deprive them of the local
23 experience that gives them some advantage in terms of
24 knowing their markets and customers slightly better
25 than people who are starting from remote locations,

1 remembering that those people have their own
2 advantages in other aspects of the industry.

3 Similarly, you don't want to deprive them of
4 their brand name marketing or advertising abilities to
5 operate. Just as the local utility has some brand
6 name recognition, many of the people who will enter
7 the market have brand name recognition. The joint
8 marketing of many products is -- is a customer-
9 friendly kind of thing. There are many customers who
10 want to consider alternatives, who want to know what
11 all of the products are that you have to offer in
12 evaluating using a potential supplier. So supplying
13 customers with information about the various things
14 that you do is pro competitive, not anticompetitive.

15 So the conclusion is that competition, not
16 competitors, ought to be the focus. We have to do the
17 things we can to promote the most competitive possible
18 market. Competition involves letting people keep
19 their legitimate advantages, whether they are
20 incumbents or whether they are entrants. The things
21 that are designed to help competitors and to prevent
22 competitor-- to make sure that competitors succeed are
23 going to be anticompetitive and will result in higher
24 prices and lower quality service.

25 Competitors can and will compete. This is

1 not a market where there are thousands of small mom
2 and pop operations starting in garages that are going
3 to be the major focus of competition in the industry.
4 This is an industry in which we have lots of very
5 large corporations who plan to be nationwide, and in
6 some cases are already worldwide competitors in the
7 market. I'd like to illustrate that by turning to
8 this other chart.

9 Reading the testimony of some witnesses, you
10 might suppose that the people who are going to be
11 coming into the market are relatively small and don't
12 have scale and scope economies, and, therefore, need
13 some protection from the utility that has a large,
14 efficient payroll department. In most states, and
15 certainly in this state, that is -- that is not the
16 case.

17 As you can see, the other likely entrants
18 into the Missouri market, on average, at least the
19 ones on this list, are significantly larger than even
20 the largest incumbent utility in the state. These are
21 the folks who will bring tremendous scale and scope
22 advantages into the market, and to disable the
23 incumbent further by depriving them of their
24 legitimate advantages makes it more likely that these
25 people will succeed but also makes it more likely that

1 the ultimate price of electricity in the market will
2 be higher than it otherwise would be and that those
3 moneys will go to the pockets of shareholders of these
4 companies rather than as reductions to the prices paid
5 by the consumers of the state of Missouri.

6 So the bottom line is, it's our very
7 strong -- my very strong view that the Commission
8 should favor a set of regulatory standards that is as
9 light-handed as possible to regulate only those things
10 that absolutely have to be regulated and regulate them
11 in as light-handed a way as possible to prevent the
12 abuse, the illegitimate advantages, but to allow all
13 of the legitimate advantages to pass through to
14 consumers and to the benefit of the market in terms of
15 lower prices and more abundant choices of products.

16 That concludes my summary. I will be happy
17 to take questions.

18 COMMISSIONER DRAINER: I would like to ask
19 that the two boards that you used, that that
20 information be given for -- so that the Commissioners
21 who cannot see it will have the information.

22 And you were ready for me. Good.

23 JUDGE THORNBURG: Do you have a copy for the
24 court reporter?

25 I'd like to have that marked as the next-

1 numbered exhibit and referred to as the chart of
2 companies that Dr. Landon referred to.

3 (EXHIBIT NO. 6 AND 7 WERE MARKED FOR
4 IDENTIFICATION.)

5 MR. JOHNSON: Do you have copies for the
6 other participants?

7 MR. FAGAN: We do not have copies of the
8 second demonstrative. The first demonstrative is
9 included in --

10 MR. JOHNSON: Maybe they can run some
11 photocopies for me?

12 MR. FAGAN: Certainly.

13 COMMISSIONER DRAINER: I have no questions,
14 but I appreciate your presentation. Thank you very
15 much.

16 DR. LANDON: Thank you.

17 JUDGE THORNBURG: Commissioner Murray?

18 COMMISSIONER MURRAY: I don't have any
19 questions.

20 I do appreciate the presentation and the
21 synopsis. That is very helpful.

22 JUDGE THORNBURG: I think I have a couple of
23 questions.

24 QUESTIONS BY JUDGE THORNBURG:

25 Q. You do some work in the communications

1 industry also?

2 A. That's correct.

3 Q. The FCC, have they adopted rules
4 regarding -- rules or regulations regarding affiliate
5 transactions?

6 A. Yes.

7 Q. And on their type of pricing -- affiliate
8 pricing guidelines, do they use something equivalent
9 to fully distributed cost as in the Missouri proposed
10 rules that --

11 A. I don't want to comment on the details. I
12 haven't looked with specificity to how they drafted
13 those rules in order to address the issue.

14 Q. With regard to preventing cross-subsidies, I
15 think your written comments may reflect this, but
16 would there be any instances where asymmetrical
17 pricing and use of fully distributed costs and market
18 values, that the -- would be areas where those be used
19 or not used?

20 A. Well, I am opposed to the asymmetrical
21 pricing proposals that Staff and OPC have made for
22 some very simple reasons. One, under asymmetric
23 pricing, a lot of transactions that would make
24 economic sense won't happen. The utility would be
25 foolish if it paid above market for -- a utility would

1 be foolish if it sold to an affiliate at a price that
2 didn't reflect the market price.

3 JUDGE THORNBURG: That's all I had. Thank
4 you.

5 DR. LANDON: You are very welcome.

6 JUDGE THORNBURG: Mr. Niehoff, I think
7 Commissioner Drainer may have one additional question
8 that perhaps you might address.

9 MR. NIEHOFF: I can sure try. Is this
10 regarding the cost estimate, Commissioner?

11 COMMISSIONER DRAINER: Yes.

12 MR. NIEHOFF. Okay. We had addressed --

13 COMMISSIONER DRAINER: It's the second day.
14 We don't know where we are. Right?

15 MR. NIEHOFF: Well, it's getting late, so
16 yes.

17 We had addressed what we thought the
18 estimated costs were somewhat generally in a letter at
19 the start of this process. Our targets were not --
20 our estimates there were not very precise, and that
21 was for a couple of reasons. First off, we weren't
22 sure how the rule would be interpreted. It's been
23 somewhat of a moving target throughout this process,
24 which is natural and to be expected.

25 However, I can tell you that we did offer up

1 a range of costs, and depending on how the rule is
2 interpreted, that's -- it would be about the best
3 response I can give you today.

4 Where you find significant cost additions in
5 an affiliate transaction rule is where you require
6 separation of facilities and services and duplication
7 of those services in the utility or in the affiliate,
8 the addition of systems or incremental employees
9 because of those decisions.

10 We have done -- in connection with an
11 Illinois rulemaking that proposed some separation of
12 employees, some separation of systems, we did an
13 evaluation there that showed that the incremental
14 costs would be \$6 to \$7 million per year to separate
15 out the functions from the utility that are somewhat
16 analogous to here.

17 Over a ten-year period, the net present
18 value was \$70 million, is what we had submitted in
19 testimony there. So the cost can be very large
20 depending on how the rule itself is written and how
21 it's interpreted.

22 COMMISSIONER DRAINER: Can I ask if the rule
23 was proposed, and would that have been the cost here
24 in Missouri --

25 MR. NIEHOFF: If --

1 COMMISSIONER DRAINER: -- as the rule that
2 you are responding to here in this area is written?
3 MR. NIEHOFF: Again, it would be hard for me
4 to be very precise because I'm not sure how it would
5 be -- how it would be implemented. But if, for
6 example -- the largest elements of those costs that we
7 described in Illinois were, for example, an inability
8 to share computer systems, hardware, things of that
9 nature. If those things --
10 COMMISSIONER DRAINER: There is nothing that
11 specific in this rule that says that.
12 MR. NIEHOFF: There are provisions that
13 don't allow a utility to grant any kind of -- an
14 affiliate any kind of a benefit, and then the benefit
15 is described in certain ways.
16 COMMISSIONER DRAINER: Well, then, let me
17 ask you, if as you have in your comments, I want to
18 say Attachment C, but your proposed rule, what would
19 the cost be as it's been proposed by Ameren?
20 MR. NIEHOFF: By Ameren? And there would be
21 costs associated with our rule.
22 COMMISSIONER DRAINER: Sure.
23 MR. NIEHOFF: Some of it we've already
24 incurred as a system to get ourselves in compliance
25 with the SEC, but we did come up with a cost

1 accounting programs, time tracking systems, and
2 allocations in order to make sure the expenses are
3 tracked and loaded to the company that created the
4 need for that.

5 I don't -- I'm not in the controller's
6 function. I can't tell you what that cost was. There
7 was -- it was a -- it was not an insubstantial cost,
8 I'm confident, given the scope of the program that we
9 have in place and my knowledge of it. So --

10 COMMISSIONER DRAINER: But as you are
11 proposing the rule in Missouri --

12 MR. NIEHOFF: Uh-huh.

13 COMMISSIONER DRAINER: -- would it be
14 significantly less than as the rule was originally
15 published by the Secretary of State's Office?

16 MR. NIEHOFF: Yes. Yes, it would, because
17 we focus on -- on limiting the nondiscriminatory
18 access to essential facilities. We allow things that
19 aren't competitive or sensitive, that aren't essential
20 to be freely shared among all companies, and for that
21 reason, our rule, we believe, saves substantial costs
22 over others that have been proposed.

23 Is that --

24 COMMISSIONER DRAINER: That's as clear as
25 mud.

1 MR. NIEHOFF: -- responsive? I'm sorry.

2 COMMISSIONER DRAINER: No. That's all

3 right. I appreciate you attempting to respond

4 seriously --

5 MR. NIEHOFF: Okay.

6 COMMISSIONER DRAINER: -- because I -- the

7 only thing that we have is kind of a thumbnail, you

8 know, sketch of \$100,000 per company, and I just did

9 not know if you had something more exact.

10 And I do appreciate sincerely your

11 responding.

12 MR. NIEHOFF: Thank you.

13 JUDGE THORNBURG: Are there any other

14 attorneys or participants in opposition to the rule

15 that would like to be heard today?

16 (No response.)

17 JUDGE THORNBURG: I'd like to just point out

18 again that today's proceedings, this transcript and

19 exhibits taken today, will be preserved in the

20 records -- related records for the heating and the gas

21 affiliate rules. And when these transcripts are

22 available, if anybody has any questions that need to

23 be cleared up about the availability of this record,

24 you can contact me here at the Commission.

25 I thank everybody for their time and

1 participation today, and if there is not anything
2 further, I will adjourn.

3 MS. SHEMWELL: I have one small matter.

4 JUDGE THORNBURG: Ms. Shemwell, yes.

5 MS. SHEMWELL: I did not respond to
6 Commissioner Drainer about the variance. My limited
7 recollection is that perhaps she hadn't come to the
8 hearing room at that point. So if I may be permitted
9 at this point to respond?

10 JUDGE THORNBURG: That would be fine.

11 MS. SHEMWELL: Is that all right?

12 JUDGE THORNBURG: That would be fine.

13 MS. SHEMWELL: We feel that under the
14 current rule that is written there is really nothing
15 to prevent a company from coming in and asking for a
16 blanket variance. Staff would review that request and
17 make a recommendation.

18 This is still at the conceptual stage, so we
19 don't really know how it's going to play out, but
20 Staff hasn't seen anything conceptually that would
21 really indicate that a company should have a blanket
22 variance that would last indefinitely.

23 We are a little bit concerned that if a lot
24 of companies are encouraged to come in and ask for a
25 blanket variance that it could significantly delay

1 implementation of rule if they weren't keeping records
2 during that period until the decision was made on
3 whether or not to grant the variance.

4 COMMISSIONER DRAINER: You have not heard
5 anything in this proceeding that has encouraged
6 companies to come in and ask for a blanket variance?

7 MS. SHEMWELL: No. My point was that we
8 haven't seen anything in looking at the rule prior to
9 the hearing, looking at what other states have done,
10 and in Staff's investigation of the matter that would
11 indicate that a blanket variance was warranted. But,
12 certainly, we would be willing to look at that. If a
13 company made its case, then we would recommend that to
14 the Commission.

15 COMMISSIONER DRAINER: Okay. Thank you.

16 JUDGE THORNBURG: Any additional comments?

17 (No responses.)

18 JUDGE THORNBURG: The hearing for this
19 proceeding will adjourn.

20 WHEREUPON, the local public hearing at
21 Jefferson City, Missouri was concluded.

22

23

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