

**BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of the General Rate Increase     )  
for Water and Sewer Service Provided by     )  
Missouri-American Water Company.            )           Case No. WR-2003-0500

**STAFF’S RESPONSE TO  
ORDER DIRECTING FILING**

**COMES NOW** the Staff and in response to the Commission’s August 16, 2005 Order Directing Filing states:

1.       On page 9 of the Commission’s Report and Order of April 6, 2004 approving the Stipulation and Agreement in this case, the Commission ordered the Company, the OPC and the Staff to “cooperate to obtain promulgation of a Commission rule on affiliate transactions applicable to Company and its affiliates by April 16, 2005.” This filing date was later extended to August 15, 2005. In response to filings of the Staff and Company on August 15, 2005, the Commission, on August 16, 2005, ordered the Staff and Missouri-American Water Company to file their proposed affiliate transaction rules for water corporations on or before September 16, 2005.

2.       As required by the August 16, 2005 Order Directing Filing, Staff hereby files its Proposed Affiliate Transactions Rule for Water Corporations that are certificated in this state.

3.       Staff modeled its Proposed Rule for Water Corporations on the currently effective Affiliate Transactions Rules for Gas utility companies operating in this state.

4.       If the Commission determines that it will open a separate case for promulgation of a Water Affiliate Transactions Rule as recommended by both the Staff and Missouri-American Water Company, Staff will file its proposed rule in that case, and is also prepared to file a

document that compares this proposed rule to the currently effective rule for gas corporations if the Commission would find that to be useful.

5. To avoid potential challenges and to clarify the status of this case, Staff renews its request that the Commission open a separate case specifically for the rulemaking.

**WHEREFORE**, the Staff respectfully requests that the Commission accept the attached Proposed Rule and recommends that the Commission promptly open a rulemaking case for promulgation of an Affiliate Transactions Rule for water utilities.

Respectfully submitted,

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#### **Certificate of Service**

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 16<sup>th</sup> day of September, 2005.

/s/ Lera L. Shemwell

**Title 4 – DEPARTMENT OF ECONOMIC DEVELOPMENT**  
**Division 240 – Public Service Commission**  
**Chapter 50 – Water Utilities**

**PROPOSED RULE**

**4 CSR 240-50.050 Affiliate Transactions**

*PURPOSE: This rule is intended to prevent regulated utilities from subsidizing their non-regulated operations. In order to accomplish this objective, the rule sets forth financial standards, evidentiary standards and record keeping requirements applicable to commission-regulated water corporations that participate in transactions with affiliated entities.*

**(1) Definitions.**

(A) Affiliated entity means any person including an individual, corporation, service company, corporate subsidiary, firm, partnership, incorporated or unincorporated association, political subdivision including a public utility district, city, town, county or combination of political subdivisions, which directly or indirectly, through one (1) or more intermediaries, controls, is controlled by, or is under common control with the regulated water corporation.

(B) Affiliate transaction means any transaction for the provision, purchase or sale of any information, asset, product or service, or portion of any product or service, between a regulated water corporation and an affiliated entity, and shall include all transactions carried out between any unregulated business operation of a regulated water corporation and the regulated business operations of a water corporation.

(C) Commission means the Missouri Public Service Commission.

(D) Control (including the terms "controlling," "controlled by," and "common control") means the possession, directly or indirectly, of the power to direct, or to cause the direction of the management or policies of an entity, whether such power is exercised through one (1) or more intermediary entities, or alone, or in conjunction with, or pursuant to an agreement with, one or more other entities, whether such power is exercised through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, affiliated entities, contract or any other direct or indirect means. The commission shall presume that the beneficial ownership of ten percent (10%) or more of voting securities or partnership interests of an entity constitutes control for purposes of this rule. This provision, however, shall not be construed to prohibit a regulated water corporation from rebutting the presumption that its ownership interest in an entity confers control.

(E) Corporate support means joint corporate oversight, governance, support systems and personnel, involving payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, research and development activities and all other corporate support functions necessary for the provision of regulated water utility service.

(F) Fully distributed cost (FDC) means a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. FDC requires recognition of all costs incurred directly or indirectly used to produce a good or service. Costs are assigned either through a direct or allocated approach. Costs that cannot be directly assigned or indirectly allocated (e.g., administrative and general) must also be included in the FDC calculation through a general allocation.

(G) Information means any data obtained by a regulated water corporation that is not obtainable by nonaffiliated entities or can only be obtained at a competitively prohibitive cost in either time or resources.

(H) Large regulated water corporation means a regulated water corporation that regularly provides service to more than 8,000 customer connections.

(I) Preferential service means information or treatment or actions by the regulated water corporation, which places the affiliated entity at an unfair advantage over its competitors.

(J) Public counsel means the Office of the Public Counsel.

(K) Regulated water corporation means every water corporation as defined in section 386.020, RSMo, subject to commission regulation pursuant to Chapter 393, RSMo.

(L) Small regulated water corporation means a regulated water corporation that regularly provides service to 8,000 or fewer customer connections.

(M) Unfair advantage means an advantage that cannot be obtained by nonaffiliated entities or can only be obtained at a competitively prohibitive cost in either time or resources.

(N) Variance means an exemption granted by the commission from any applicable standard required pursuant to this rule.

(2) Standards.

(A) Regulated water corporations shall not provide a financial advantage to any affiliated entity, nor shall they incur increased operating costs as a result of a parent or a service company providing a financial advantage to any affiliated entity. For the purposes of this rule, a regulated water corporation shall be deemed to provide a financial advantage to an affiliated entity, if –

1. It compensates an affiliated entity for goods or services above the lesser of –

A. The fair market price; or

B. The fully distributed cost to the regulated water corporation to provide the goods or services for itself; or

2. It transfers information, assets, goods or services of any kind to an affiliated entity below the greater of –

A. The fair market price; or

B. The fully distributed cost to the regulated water corporation.

(B) Except as necessary to provide corporate support functions, regulated water corporations shall conduct their business in such a way as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time.

(C) Specific customer information shall be made available to affiliated or unaffiliated entities only upon consent of the customer or as otherwise provided by law or commission rules or orders, except for those situations where such information is necessary to provide regulated utility services. However, an affiliated entity that receives specific customer information necessary for providing regulated utility services cannot provide that information to other affiliated entities. General or aggregated customer information shall be made available to affiliated or unaffiliated entities upon similar terms and conditions. Regulated water corporations may set reasonable charges for costs incurred in producing customer information. Customer information includes information provided to a regulated water corporation, or any affiliated entity, by affiliated or unaffiliated entities.

(D) Regulated water corporations shall maintain records of complaints against affiliated entities that are providing services to their customers, when they are made aware of such complaints (directly or through a service company affiliate). These records shall consist of a log detailing the date the contact was made, the name of the customer that made the contact, and a brief description of the issues addressed by customer.

(E) Regulated water corporations shall not participate in any affiliated transactions that are not in compliance with this rule, except as provided for in section (10) of this rule.

(F) If a customer requests information from a regulated water corporation about goods or services provided by an affiliated entity, the regulated water corporation may provide information about its affiliate, but must inform the customer that regulated services are not tied to the use of an affiliate provider and that other service providers may be available. The regulated water corporation may provide reference to other service providers or to commercial listings, but is not required to do so.

(G) Marketing materials, information or advertisements used by an affiliated entity that share an exact or similar name, logo or trademark of a regulated water corporation shall clearly display or announce that the affiliated entity is not regulated by the commission.

(3) Evidentiary Standards for Affiliate Transactions.

(A) When a regulated water corporation purchases information, assets, goods or services from an affiliated entity, the regulated water corporation shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.

(B) In transactions that involve either the purchase or receipt of information, assets, goods or services by a regulated water corporation from an affiliated entity, the regulated water corporation shall document both the fair market price of such information, assets, goods and services and the fully distributed cost to the regulated water corporation to produce the information, assets, goods or services for itself.

(C) In transactions that involve the provision of information, assets, goods or services to affiliated entities, the regulated water corporation must demonstrate that it –

1. Considered all costs incurred to complete the transaction;
2. Calculated the costs at times relevant to the transaction;
3. Allocated all joint and common costs appropriately; and
4. Adequately determined the fair market price of the information, assets, goods or services.

(D) In transactions involving the purchase of goods or services by a large regulated water corporation from an affiliated entity, the large regulated water corporation shall use a commission-approved cost allocation manual (CAM) that sets forth its cost allocation, market valuation and internal cost methods. If approved by the commission, a large regulated water corporation's CAM can use benchmark practices to establish compliance with the market value requirements of this section.

(4) Record Keeping Requirements.

(A) All regulated water corporations shall maintain their books, accounts and records separate from those of their affiliates.

(B) All large regulated water corporations, and any small regulated water corporations that are subject to a commission affiliate transaction rule for another utility service (i.e., gas or electric), shall maintain the following information on a calendar year basis, with the information to be maintained in a mutually agreed-to electronic format (i.e., agreement between the commission staff, the public counsel and the subject regulated water corporation), and shall provide such information to the commission staff and the public counsel no later than March 15 of the succeeding year:

1. A full and complete list of all affiliated entities as defined by this rule;
2. A full and complete list of all goods and services provided to or received from affiliated entities;
3. A full and complete list of all contracts entered with affiliated entities;
4. A full and complete list of all affiliate transactions undertaken with affiliated entities without a written contract together with a brief explanation of why there was no contract;
5. The amount of all affiliate transactions, by affiliated entity and account charged;
6. For any affiliate that allocates costs to a regulated water corporation, a listing and basis for the allocation factors applied to all affiliates. Any change in allocation methodology used to develop allocation factors from the previous year must be fully explained;
7. The basis used (e.g., fair market price, FDC, etc.) to record each type of affiliate transaction;
8. CAMs shall include reports that are routinely prepared on a monthly basis, that are associated with transactions that a large regulated water corporation has with any affiliate.

9. Any report that is specifically prepared for a CAM needs only to be prepared on an annual basis. However, such information shall be made available on a monthly basis in the context of any general rate proceeding.

10. Large regulated water corporations shall include in their annual CAM the criteria, guidelines and procedures they will follow to be in compliance with this rule.

(C) All small regulated water corporations that are not subject to the provisions of subsection (4)(B) of this rule shall maintain the following information regarding affiliate transactions on a calendar year basis, with the information to be available for review by the commission staff or the public counsel no later than March 15 of the succeeding year, if requested:

1. Records identifying the basis used (e.g., fair market price, FDC, etc.) to record all affiliate transactions; and
2. Books of accounts and supporting records in sufficient detail to permit verification of compliance with this rule.

(5) Records of Affiliated Entities.

(A) If a regulated water corporation has direct or indirect transactions with its parent and/or any other affiliated entities, the regulated water corporation shall ensure that its parent and/or the other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliated entity and charged to the regulated water corporation;
2. Documentation of the methods used to allocate and/or share costs between affiliated entities, including other jurisdictions and/or corporate divisions;
3. Description of costs that are not subject to allocation to affiliate transactions and documentation supporting the nonassignment of these costs to affiliate transactions;
4. Descriptions of the types of services that corporate divisions and/or other centralized functions provided to any affiliated entity or division accessing the regulated water corporation's contracted services or facilities;
5. Names and job descriptions of the employees from the regulated water corporation that transferred to a nonregulated affiliated entity;
6. Evaluations of the effect on the reliability of services provided by the regulated water corporation resulting from the access to regulated contracts and/or facilities by affiliated entities; and
7. Policies regarding the availability of customer information and the access to services available to nonregulated affiliated entities desiring use of the regulated water corporation's contracts and facilities.

(6) Access to Records of Affiliated Entities.

(A) To the extent permitted by applicable law and pursuant to established commission discovery procedures, regulated water corporations shall make available the books and records of their parents and/or any other affiliated entities with which they had direct or indirect transactions when required in the application of this rule.

(B) The commission shall have the authority to –

1. Review, inspect and audit the books, accounts and other records kept by a regulated water corporation or an affiliated entity with which the regulated water corporation had direct or indirect transactions for the sole purpose of ensuring compliance with this rule and make findings available to the commission; and
2. Investigate the operations of a regulated water corporation or an affiliated entity with which the regulated water corporation had direct or indirect transactions and their relationship to each other for the sole purpose of ensuring compliance with this rule.

(C) This rule does not modify existing legal standards regarding which party has the burden of proof in commission proceedings.

(7) Record Retention.

(A) Records required under this rule shall be maintained by each regulated water corporation for a period of not less than six (6) years.

(8) Enforcement.

(A) When enforcing the standards set forth in this rule, or any order of the commission regarding those standards, the commission may apply any remedy available to the commission.

(9) Regulated water corporations shall train and advise their personnel as to the requirements and provisions of this rule, as necessary to ensure compliance with this rule.

(10) Variances.

(A) A variance from the standards in this rule may be obtained by compliance with paragraphs (10)(A)1. or (10)(A)2. The granting of a variance to one regulated water corporation does not constitute a waiver for any other regulated water corporation, nor does it otherwise affect the requirement for other regulated water corporations to comply with the standards in this rule. The scope of a variance shall be determined based on the facts and circumstances found in support of the application.

1. Regulated water corporations shall submit requests for variances in accordance with commission rule 4 CSR 240-2.060; or

2. Regulated water corporations may engage in an affiliate transaction not in compliance with the standards set out in subsection (2)(A) of this rule, when to their best knowledge and belief, compliance with those standards would not be in the best interests of their regulated customers, and if they comply with the procedures required by subparagraphs (10)(A)2.A., (10)(A)2.B. and (10)(A)2.C. of this rule, as applicable –

A. All reports and record retention requirements for each affiliate transaction must be complied with;

B. Large regulated water corporations shall file notice of the noncomplying affiliate transaction with the secretary of the commission and the public counsel within ten (10) days of the occurrence of the noncomplying affiliate transaction. The notice shall provide a detailed explanation of why the noncomplying affiliate transaction should be exempted from the requirements of subsection (2)(A), and shall provide a detailed explanation of how the noncomplying affiliate transaction was in the best interests of the regulated water corporation's customers. Within thirty (30) days of the notice of the noncomplying affiliate transaction, any party shall have the right to request a hearing regarding the noncomplying affiliate transaction. The commission may grant or deny the request for hearing at that time. If the commission denies a request for hearing, the denial shall not in any way prejudice a party's ability to challenge the noncomplying affiliate transaction at the time of a large water corporation's annual CAM filing. At the time of the filing of a large regulated water corporation's annual CAM filing the large regulated water corporation shall provide to the secretary of the commission a listing of all noncomplying affiliate transactions that occurred between the period of the last filing and the current filing. Any noncomplying affiliate transaction submitted pursuant to this section shall remain interim and subject to disallowance, pending final commission determination on whether the noncomplying affiliate transaction resulted in the best interests of the regulated customers; and

C. Small regulated water corporations shall maintain an annual list of noncomplying affiliate transactions.

(11) Nothing contained in this rule nor any action taken by the commission under the provisions of this rule shall be construed to approve or exempt any activity or arrangement that would violate the antitrust laws of the state of Missouri or of the United States or to limit the rights of any person or entity under those laws.