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December 15, 1999

FILED<sup>3</sup>

DEC 15 1999

Mr. Dale Hardy Roberts  
Public Service Commission  
P. O. Box 360  
Jefferson City, MO 65102

Missouri Public  
Service Commission

**RE: Affiliate Transactions Docket - Case No. EX-99-442**

Dear Mr. Roberts:

Enclosed for filing in the above-referenced proceeding please find an original and fourteen copies, of MPS's and Empire's Application for Rehearing, Motion for Reconsideration, and Motion for Stay. Please stamp the enclosed extra copy "filed" and return same to me.

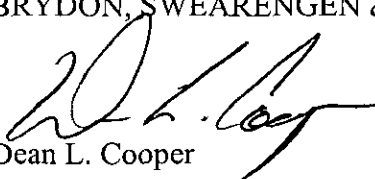
If you have any questions concerning this matter, then please do not hesitate to contact me. Thank you very much for your attention to this matter.

Sincerely,

BRYDON, SWEARENGEN & ENGLAND P.C.

By:

Dean L. Cooper



DLC/rhg

Enclosures

cc: Office of the Public Counsel

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

FILED<sup>3</sup>  
DEC 15 1999

In the Matter of the Missouri Public )  
Service Commission's Proposed Rule )  
Regarding Affiliate Transactions for )  
Electric Utilities )

Case No. EX-99-442

Missouri Public  
Service Commission

**MPS AND EMPIRE'S  
APPLICATION FOR REHEARING,  
MOTION FOR RECONSIDERATION  
AND MOTION FOR STAY**

COME NOW UtiliCorp United Inc. d/b/a Missouri Public Service, ("MPS") and The Empire District Electric Company ("Empire"), and, pursuant to Section 386.500 RSMo 1994, state as follows to the Missouri Public Service Commission ("Commission") as their application and motions in the above-captioned case:

1. On November 16, 1999, the Commission issued a "memorandum" order which authorized the filing of an Order of Rulemaking with the Office of the Secretary of State. The Secretary of State received the Order of Rulemaking (the "Order") on November 22, 1999, for publication in the *Missouri Register*. The Order adopts a rule relating to transactions between an electrical corporation and an affiliate of the electrical corporation designated as Commission Rule 4 CSR 20.015 ("the Rule"). It is stated that the Rule adopted by the Order is to become effective "30 days after publication in the Code of State Regulations."

2. The Order and the Rule do not comply with the standards set forth in Sections 386.500 and 386.510, RSMo 1994 for the reasons described below.

3. First, the Commission made no finding that Missouri utilities' existing methods or practices are unjustly discriminatory or unduly preferential was made by the Commission. *See*, §

393.140(5) RSMo 1994. Moreover, almost all Missouri electric utilities have been before the Commission in recent years for rate proceedings and there has likewise been no finding of discrimination or undue preference in those cases.

4. Second, by the use of the asymmetrical pricing standard in 4 CSR 240-20.015(2)(A), which governs the transfer of assets or services between a utility and its affiliate, or between the regulated and unregulated operations of a single utility, the Commission has taken steps beyond those which are permitted by statute. The Commission, of course, has statutory authority to set the price of electricity sold by electrical corporations to customers in Missouri, and to prescribe the terms and conditions under which such electricity is to be sold to the customers of the electrical corporation in Missouri. However, the asymmetrical pricing standard has the effect of controlling the price of non-regulated transactions.

5. Under the Commission's new rule, certain transactions are required to be valued at either market value or fully distributed cost, depending upon which approach is *least favorable* to the utility. There is no statutory authority giving the Commission authority to mandate the pricing formula at which a utility transfers goods or services which are not used or useful in providing utility service. This pricing method also conflicts with a pricing method in § 386.756 RSMo Supp. 1998, established by the General Assembly for similar types of transactions.

6. MPS and Empire recognize that the Commission has moderated the rules somewhat from proposals that have been made. However, this moderation has not gone far enough in order to provide for an efficient and effective market that will benefit Missouri consumers.

7. A more appropriate standard would be that proposed by Kenneth W. Costello of The National Regulatory Research Institute in his paper *A Pricing Rule for Affiliate*

*Transactions: Room for Consensus* (October 1998). Mr. Costello proposed the following language on the pricing of affiliate transactions:

Generally, the price for services and products provided by a regulated entity to its non-regulated affiliate should be at [fully distributed costs ("FDC")]. When readily available, market prices should be considered the preferred pricing method. In other situations, prices can be less than FDC but at or above [incremental cost ("IC")]. The latter requires regulatory approval after a utility provides adequate market and other relevant information and after consideration of the tradeoff between economic efficiency and "fairness" goals.

Generally, the price for services and products provided by an affiliated company to a regulated affiliate should be at FDC. When readily available, market prices should be considered the preferred pricing method. In other situations, prices can be less than FDC based on incremental, negotiated prices or a competitive bidding process, as determined by the regulator after consideration of the tradeoff between economic efficiency and "fairness" goals.

(Costello, p. 22-23).

8. This language recognizes an emphasis on FDC. However, it also acknowledges situations for which alternate transfer-pricing measures would be preferable, thereby giving utilities flexibility in pricing affiliate transactions. One such situation would be when market prices for identical or similar products or services exist. Another is when costs differing from FDC may be more appropriate in view of prevailing market conditions. (Costello, p. 23).

9. Because there is no finding of discrimination or abuse, the new regulation will serve only to burden the transaction process and result in uneconomic decisions. This has been more fully described by Mr. Costello as follows:

The popular "higher of" and "lower of" (or what is often referred to as "asymmetric pricing") provision contained in some states' rules pertaining to the pricing of affiliate transactions seems unnecessary or counterproductive and fundamentally devoid of any sound economic principle. In the first case, where the affiliate of a utility pays the "higher of FDC or market prices" for products or services from a utility, the utility may forego profits that it could otherwise earn. For example, assume that the market price for a service provided by a utility to its affiliate is \$10 but the FDC to the utility is \$13 and the IC to the utility is \$8.

Under the "higher of" language, the affiliate would be required to pay \$13. But since the market price for the same service is only \$10, the affiliate would purchase the service from someone else and save \$3 (\$13 - \$10). From the utility's perspective, it loses the opportunity to sell the service to its affiliate at a profit. For example, by selling the service at the market price of \$10, the utility makes \$2 in profits (the market price minus the utility's IC, or the contribution to fixed and common costs). All or a portion of the \$2 may be credited to the utility's customers in lower rates.

As a general rule, when FDC exceeds the market price, with the affiliate having to pay the former, the affiliate will look to other providers, if available, to buy the service. Buying elsewhere, as shown in the above example, can deprive the utility and its customers of economic gains. Of course, this assumes that the utility is unable to sell the service to another consumer at the market price. To the extent it can, however, the utility is left harmless with the only effect being on the affiliate who has to look elsewhere for the service.

In the "lower of" situation with regard to sale of a product or service by an affiliate to a utility, the affiliate may decide not to make such a sale. Let us assume that the affiliate's FDC for a service is less than the market price. The affiliate would then be better off by selling to someone else since it could receive the market price instead of the lower FDC. The utility would have to acquire the service from someone else at the market price. The "lower of" provision merely discourages the sale of a service or product from an affiliate to a utility. The utility is unaffected when it can purchase the same service from another party at the market price, with the affiliate forced to sell its service or product to someone else.

In sum, the "higher of" or "lower of" provision has the intended purpose of maximizing the economic gains to the utility from affiliate transactions (presumably, some or all of which can be credited to the utility's customers). In reality, however, the provision would have no effect or, in the worst case, a negative effect on the utility's profits.

10. It is important that the Commission first determine whether the market is working prior to creating an additional regulatory process that has no demonstrated need. The need to do this is well described by Alfred Kahn in his article, *"Deregulation: Micromanaging the Entry and Survival of Competitors."* The following principle, which is one of several principles for efficient competition, describes the necessity for a demonstrated need well:

5. Weighing the trade off between safeguards and efficiency; the true test is

empirical - the encouragement or preservation of competition or protection of competitors from unfair, exclusionary practices may conceivably, in extreme cases, require denying incumbent monopolists the full opportunity to exploit economies of scale and scope. Any such determination can logically be made, however, only on the basis of a searching assessment of the factual situation in the markets in question, which must involve consideration of whether rivals of the incumbent utilities may enjoy similar or offsetting economies or competitive advantages. In the absence of such a thorough assessment, there is no substitute for seeing whether competition does in fact succeed rather than assuming it will not.

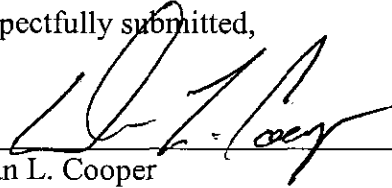
(Kahn, p. 9-10).

11. The Commission has the authority, in accordance with section 386.500.3, RSMo, to stay the effective date of its Order. Because these rules will have a significant impact upon the electric industry in Missouri, MPS and Empire move that the Commission stay the effective date until such time as the appellate issues have run their course.

WHEREFORE, UtiliCorp United Inc., d/b/a Missouri Public Service and The Empire District Electric Company, respectfully request that the Commission issue an Order: 1) staying the effective date of the Rule; 2) granting rehearing or reconsideration for the reasons stated above; 3) adopting the language cited in paragraph seven above concerning the pricing of affiliate transactions and eliminating the asymmetrical pricing standard now found in 4 CSR 240-20.015(2)(A); and 4) granting such

further relief as the Commission shall find reasonable and just.

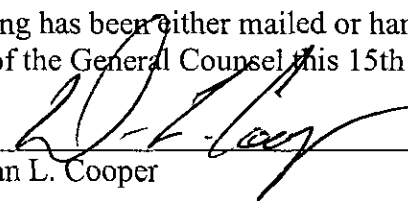
Respectfully submitted,



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(573) 635-3847 facsimile  
Attorney for UtiliCorp United Inc., d/b/a  
Missouri Public Service and  
The Empire District Electric Company

**Certificate of Service**

I hereby certify that a copy of the foregoing has been either mailed or hand-delivered to the Office of the Public Counsel and the Office of the General Counsel this 15th day of December, 1999.

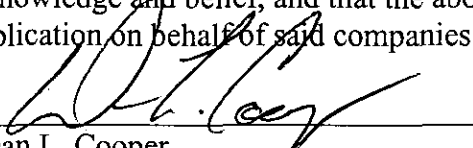


Dean L. Cooper

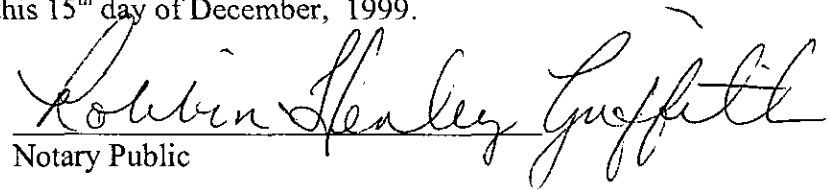
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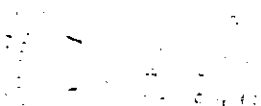
STATE OF MISSOURI     )  
                                  ) ss  
COUNTY OF COLE     )

On the 15th day of December, 1999, before me appeared Dean L. Cooper, to me personally known, who, being by me first duly sworn, states that he is the attorney for UtiliCorp United Inc. d/b/a Missouri Public Service and The Empire District Electric Company and acknowledged that he had read the above and foregoing document and the allegations therein are true and correct to the best of his information, knowledge and belief, and that the above designated attorney is authorized to file said application on behalf of said companies.

  
\_\_\_\_\_  
Dean L. Cooper

Subscribed and sworn to before me this 15<sup>th</sup> day of December, 1999.

  
\_\_\_\_\_  
Notary Public

  
ROBBIN HENLEY GRIFFITH  
A Notary Public of  
Miller County, Missouri  
My Commission Expires 12/28/2001