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Witness: Matthew R. Young
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MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION

UTILITY SERVICES - AUDITING

DIRECT TESTIMONY

OF

MATTHEW R. YOUNG

CENTRAL RIVERS WASTEWATER UTILITY, INC.

CASE NO. SR-2014-0247

Jefferson City, Missouri
November 2014

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1 **DIRECT TESTIMONY**
2 **OF**
3 **MATTHEW R. YOUNG**
4 **CENTRAL RIVERS WASTEWATER UTILITY, INC.**
5 **CASE NO. SR-2014-0247**

6 Q. Please state your name and business address.

7 A. Matthew R. Young, Fletcher Daniels State Office Building, 615 East 13th
8 Street, Room G-8, Kansas City, Missouri 64106.

9 Q. By whom are you employed and in what capacity?

10 A. I am a Utility Regulatory Auditor for the Missouri Public Service Commission
11 (“Commission”).

12 Q. Please describe your educational background and work experience.

13 A. I graduated from the University of Missouri – Kansas City with a Bachelor of
14 Liberal Arts in May 2009. I also attended graduate school at the University of Missouri –
15 Kansas City and earned a Master of Science degree, with major emphasis in Accounting, in
16 December 2011. After my education, I commenced employment with the Commission in
17 July 2013.

18 Q. What job duties have you had with the Commission?

19 A. I have assisted with and conducted audits and examinations of the books and
20 records of public utility companies operating within the state of Missouri. I have participated
21 in examinations of natural gas, district heating and industrial steam service, and water and
22 sewer operations. I have been involved in cases concerning proposed rate increases, asset sale
23 cases, infrastructure replacement surcharge cases, and certificate cases.

1 Q. Have you previously filed testimony before this Commission?

2 A. Yes. I have filed testimony reflecting audit findings in rate case audits by
3 contributing sections to Staff's Cost of Service Reports. Attached to this direct testimony is
4 Schedule MRY-1, which details the major audits and other case work in which I participated
5 as well as the scope of the audits I have performed.

6 Q. With reference to Case No. SR-2014-0247, have you examined and studied the
7 books and records of Central Rivers Wastewater Utility, Inc. ("Central Rivers," which I also
8 refer to as "Company") regarding its sewer operations?

9 A. Yes, with the assistance of other members of the Staff of the Commission
10 ("Staff").

11 Q. Did you participate in Staff's investigation of Central Rivers' application for a
12 small company rate increase request?

13 A. Yes. The scope of my participation in Staff's investigation includes the
14 utility's corporate affiliations, revenues, expenses, and rate base. I developed the overall
15 revenue requirement in this case using the Commission's revenue requirement model known
16 as the Exhibit Modeling System ("EMS"). The EMS run I developed for Central Rivers is
17 being filed concurrently with this testimony.

18 Q. Why did Staff review Central Rivers' books and records and calculate a
19 revenue requirement for the Company in this case?

20 A. On March 11, 2014, Central Rivers filed for a rate increase for its sewer
21 operations under the Commission's informal small company rate case process. The
22 Commission assigned the filing Case No. SR-2014-0247. In the application, Central Rivers
23 requested an annual rate increase of \$91,790.

1 Q. What is the purpose of your testimony?

2 A. My testimony gives an overview of the Company's organizational structure
3 and operations, a description of the audit steps performed, and Staff's recommendations
4 related to the Company's revenues, expenses, and rate base. The EMS run, filed concurrently
5 with this filing, presents Staff's computation of the revenue requirement for this case and
6 identifies the necessary assumptions made by Staff during its review.

7 Q. How did Staff conduct its audit of Central Rivers?

8 A. Staff issued requests for information on how the Company operates its sewer
9 systems and undertakes utility business matters. Staff issued Data Requests during its review
10 of Central Rivers to determine the cost structure of the Company. Staff made on-site visits to
11 Central Rivers' headquarters and interviewed the owner of the Company along with personnel
12 who provide managerial, operational, and clerical services to Central Rivers under
13 contract. Staff inspected and toured the various sewer systems owned and operated by the
14 Company. Staff interacted with Company representatives through electronic communication
15 and conference calls to inquire about various aspects of Central Rivers operations. Staff
16 submitted follow-up inquiries for clarification of information. Staff conducted outside
17 research regarding the utility operations of Central Rivers. Staff had numerous internal
18 discussions to coordinate the review of Central River's rate request. Finally, Staff
19 participated in several meetings with the Company and members of The Office of Public
20 Counsel to discuss various concerns about the rate case request.

21 Q. Is Staff's approach in the audit of Central Rivers' rate request typical of how it
22 conducts audits of other water and sewer rate cases?

1 A. Yes. The audit activities described above are typical Staff activities during all
2 of its audits using the small rate case procedure for water and sewer companies that are
3 regulated by the Commission.

4 **I. EXECUTIVE SUMMARY**

5 Q. Please provide a summary of Staff’s findings in this rate case.

6 A. Staff’s audit findings, based on numerous assumptions, indicate a rate increase
7 as identified in the Exhibit Modeling System filed concurrently with this testimony. Staff had
8 to make a material number of assumptions because adequate cost information relating to the
9 maintenance and operations of the Company’s sewer systems was not provided by Central
10 Rivers.

11 Central Rivers has an affiliate, Construction Services and Management, LLC
12 (“Construction Company”) that shares common ownership with the utility. A contract exists
13 between the two companies that authorize this affiliate to provide all managerial, operational,
14 and clerical functions that are necessary to provide sewer service to the utility customers.

15 The Construction Company is not regulated nor under the jurisdiction of the
16 Commission. The contractual agreement allows this non-regulated affiliate to make all
17 decisions and control all aspects of the regulated sewer operations. Because the Construction
18 Company and the utility have common ownership, all decision making authority related to
19 utility matters resides not in Central Rivers, but with the Construction Company. Since
20 Central Rivers does not have the authority to make business decisions, it cannot represent the
21 financial, operating, and regulatory interests of the Company or defend against decisions
22 made by the Construction Company, including the Construction Company’s decision to
23 withhold information supporting the actual costs of utility business.

1 The aforementioned contract defines the type and frequency of services the
2 Construction Company performs for Central Rivers and provides the costs of the agreement.
3 This contract was not executed through “arms-length” negotiations. As such, the costs
4 incurred by Central Rivers is completely at the affiliated Construction Company’s discretion
5 and, because of common ownership, the costs are controlled by one individual that owns both
6 companies. During this rate case audit, the Construction Company refused to provide
7 sufficient records necessary to justify that the utility’s costs from the contract effective
8 January 1, 2014 are reasonable and prudent.

9 The refusal to provide supporting documentation resulted in Staff using various
10 assumptions while processing the rate increase request and at this time, any rate
11 recommendation by Staff would not be based on actual cost information. Therefore, Staff is
12 recommending that no increase to Central Rivers’ rates or fees be approved in this case.

13 **II. TEST YEAR AND UPDATE PERIOD**

14 Q. What test year is being used in this case?

15 A. The test year is the calendar year, 2013.

16 Q. Is there an update period being used in this case?

17 A. Yes. The update period is March 31, 2014.

18 Q. What is a purpose of a test year?

19 A. A test year is a historical year from which actual information is used as the
20 starting point for determining an annual revenue requirement to see if any shortfall or excess
21 of earnings exist. Adjustments are made to that information so that, as adjusted, it reflects the
22 normal annual revenues and operating costs of the rate-regulated utility. The normal annual
23 revenue and operating costs incurred to provide utility service going forward form the basis

1 for determining what the utility's rates need to be in order to provide it the opportunity to
2 collect sufficient revenues both to pay for those ongoing costs and to earn a reasonable return
3 on its investment. In determining ongoing revenues and costs to develop the utility's revenue
4 requirement, the first step is to identify the test year costs levels, which serve as the starting
5 point for making all the adjustments to arrive at the revenue requirement recommendation.
6 The Commission concisely stated the purpose of using a test year in its Order in KCPL's 1983
7 general rate case, Case No. ER-83-49:

8 The purpose of using a test year is to create or construct a
9 reasonable expected level of earnings, expenses and
10 investments during the future period in which the rates, to be
11 determined herein, will be in effect. All of the aspects of the
12 test year operations may be adjusted upward or downward to
13 exclude unusual or unreasonable items, or include unusual
14 items, by amortization or otherwise, in order to arrive at a
15 proper allowable level of all of the elements of the Company's
16 operations. The Commission has generally attempted to
17 establish those levels at a time as close as possible to the period
18 when the rates in question will be in effect.

19 Q. What is the purpose of an update period?

20 A. The update period (sometimes also known as the "known and measurable
21 period") is critical to the development of new rates. New rates resulting from rate cases, even
22 informal rate cases such as this one, can take up to eleven months to go into effect from the
23 time the case is filed. A utility's revenue requirement, based on the historical test year, may
24 change significantly while its case is being processed. To better match new rates with the
25 utility's ongoing revenue requirement, update periods are utilized. Test year information is
26 updated to reflect changes through the update cut-off date—in this case March 31, 2014.

27 Selecting a "known and measurable date" or "known and measurable period" is even
28 more important than selection of a test year in synchronizing and capturing—"matching"—
29 all revenues and expenses as this updated information will form the basis for changing rates.

1 Just as with the test year, a proper determination of revenue requirement is dependent upon a
2 consideration of all material components of the rate base, return on investment, current level
3 of revenues, along with operating costs, at the same point in time. This ratemaking principle
4 is common to all rate cases and common to how the Commission has established rates using
5 all material and relevant cost component to develop the revenue requirement calculation. The
6 March 31, 2014 date for the known and measurable period was chosen to enable the parties
7 and Staff an update period that provides sufficient time to obtain actual information from the
8 Company upon which to perform analyses and make calculations regarding various
9 components of the revenue requirement and still base the revenue requirement
10 recommendation used for proposing new prospective rates on very recent information.

11 **III. CENTRAL RIVERS' BUSINESS STRUCTURE**

12 Q. Please provide a brief overview of Central Rivers.

13 A. Central Rivers provides sewer service to seven subdivisions, most of which are
14 located near Kearney, Missouri. Two outlying subdivisions are located near Cameron,
15 Missouri and Orrick, Missouri. Each subdivision's sewer infrastructure, except one, includes
16 a septic tank effluent pump ("STEP") unit located on the premises of each of the utility
17 customers' lots in each subdivision. Each STEP unit is then connected through a pressurized
18 service sewer to a pressurized collection system (pressurized by the pumps in the septic tanks)
19 that transports effluent to a recirculating sand filter treatment facility. The unique subdivision
20 that does not have STEP systems for each customer utilizes conventional gravity collecting
21 sewers to transport sewage from customers' premises to a central septic tank. From this tank,
22 sewage flows to a recirculating sand filter treatment facility. Each subdivision operates

1 independently from one another necessitating a separate treatment facility and collection
2 system for each service area.

3 Q. How many customers does Central Rivers have?

4 A. As of the update period, March 31, 2014, the Company had 241 total
5 customers for the 7 individual sewer systems. The breakdown of the customer count in the
6 sewer systems is:

7

Subdivision	County	Number of Customers
Countryside Meadows	Ray	7
Fox Run	Clay	40
Wilmar Estates	Clay	64
Park Estates and Bar-B Acres	Clay	46
Private Gardens	Clay	45
Berkshire Glen	Clay	30
Country Hill Estates	Clinton	9
Total customers in seven certificated service areas:		241

8
9 Q. Does the Company employ individuals to repair, maintain, and operate the
10 sewer utility plant assets?

11 A. No. The Company has no employees. To fulfill the clerical, managerial, and
12 operational duties that are necessary in the course of operating a sewer utility, Central Rivers
13 has entered into a contract with the Construction Company, effective January 1, 2014. The
14 contract between the two companies (hereafter referred to as "the contract") is attached to this
15 direct testimony as Schedule MRY-2.

16 Q. Who signed the contract between Central Rivers and the Construction
17 Company?

1 A. The owner of Central Rivers signed on behalf of the utility. The father of the
2 owner of Central Rivers signed on behalf of the Construction Company as its manager.
3 Furthermore, Staff found that the owner (as opposed to the manager) of the Construction
4 Company is the same individual who owns Central Rivers. Clearly, the two businesses
5 are affiliated.

6 Q. Does the Commission have a rule that defines the term “affiliate?”

7 A. Yes, there are multiple definitions of an affiliate in the rules of the
8 Commission. Commission Rule 4 CSR 240-14.010(6)(A), a rule devoted to the promotional
9 practices of electric and natural gas corporations, provides the following definition of
10 an affiliate:

11 Affiliate shall include any person who, directly or indirectly,
12 controls or is controlled by or is under common control with a
13 public utility;

14 Q. Do you think this definition of an affiliate applies to this case even though the
15 rule cited is not directed specifically at sewer companies?

16 A. Yes. This definition of an affiliate is similar to definitions found in other
17 Commission affiliated transaction rules. 4 CSR 240-20.015 (1)(A) and 4 CSR 240-40.015
18 (1)(A) provide standards for the affiliated transactions of regulated electric and natural gas
19 utilities respectively.

20 Q. Why did the Commission promulgate those rules?

21 A. The first sentence of both rules state the following:

22 PURPOSE: This rule is intended to prevent regulated utilities
23 from subsidizing their non-regulated operations.

1 Q. How do these definitions and rules apply to Central Rivers?

2 A. In this case, the owner of the Construction Company is a person who directly
3 controls Central Rivers through his ownership of the regulated public utility. This common
4 ownership allows one individual to have complete and direct control of both the Construction
5 Company and Central Rivers thus; the two entities are affiliated, creating the risk of Central
6 Rivers subsidizing the non-regulated operations of the Construction Company.

7 Q. From an auditor's perspective, how does the existence of affiliated companies
8 and individuals affect the audit process?

9 A. Affiliated companies increase the level of an auditor's due diligence required
10 during the audit, especially when the affiliates are engaging in recurring and non-recurring
11 transactions. In this instance, there are several affiliated transactions defined in the contract
12 (Schedule MRY-2) between the Construction Company and Central Rivers. While auditors
13 do not assume that abuse is occurring while auditing affiliated transactions, there is a higher
14 degree of opportunity for abuse when utilities do business with affiliated entities and that
15 requires an increase in the level of an auditor's scrutiny and professional skepticism.

16 Q. Is it your opinion that affiliated transactions create an opportunity for abuse?

17 A. Yes. It is an opinion I share with the staff of the United States Congress.
18 Schedule MRY-3 is a staff memorandum issued in the Congressional staff investigation of
19 Enron and its pipeline subsidies following Enron's collapse is the following excerpt¹:

20 [W]henever a company conducts transactions among its own
21 affiliates there are inherent issues about the fairness and
22 motivations of such transactions. ... One concern is that where
23 one affiliate in a transaction has captive customers, a one-sided
24 deal between affiliates can saddle those customers with
25 additional financial burdens. Another concern is that one

¹ Staff of Senate Committee on Governmental Affairs, *Committee Staff Investigation of the Federal Energy Regulatory Commission's Oversight of Enron Corp.* Page 26, note 75 (Nov. 12, 2002)

1 affiliate will treat another with favoritism at the expense of
2 other companies or in ways detrimental to the market as a
3 whole.

4 Q. Specific to Central Rivers, what was Staff's concern during the audit?

5 A. Staff's concern was that the owner of the Construction Company was and is
6 collecting money from the utility for services at amounts that exceed market value for the
7 equipment and services provided as well as receiving an excessive profit through the affiliated
8 transactions. Staff's opinion is that the utility's ratepayers should not be responsible for
9 providing excessive profits not only to the utility, but also to the 3rd party vendors hired by the
10 utility to conduct business.

11 Under the circumstances where the 3rd party is compensated based on arms-length
12 negotiations, the risk of excessive profits is mitigated by the concept of competitive markets.
13 During a competitive bidding process, a vendor will offer its services at a price comparable to
14 competitive vendors, and the vendor's profits will reflect the industry standard.

15 However, the negotiation with the 3rd party vendor hired by Central Rivers was not an
16 arms-length negotiation. The prices established for services provided by the Construction
17 Company to Central Rivers are not competitive because the competitive market did not
18 influence the total price or the profit built into those prices. Since the contract is not
19 competitive, the risk of the Construction Company earning excessive profits exists as well as
20 the potential for a cross-subsidy. Furthermore, if a subsidy exists, it would be a detriment to
21 the utility's ratepayers.

22 Q. Do the expenses being paid to the Construction Company by Central Rivers
23 meet or exceed a reasonable materiality level?

24 A. Yes. The ratio of cash paid to the Construction Company versus all other cash
25 paid exceeds any reasonable materiality limit. According to Central Rivers' books and

1 records, the total of the amounts paid to the Construction Company summed to approximately
2 80% of the total cash expenditures during the calendar year 2013. In other words, the vast
3 amount of the expenses incurred by Central Rivers is under the direct control of the
4 Construction Company.

5 Q. Do you think that the contract between the Construction Company and Central
6 Rivers represents an arrangement that is fair to the Company and the ratepayers?

7 A. I cannot make a determination on the fairness of the contract until I have
8 evaluated if it is representative of the type of contract that would be agreeable between two
9 entities that engage in arms-length transactions. In other words, I cannot say it is fair or unfair
10 to the Company and the ratepayers until I am satisfied that the affiliated transactions that are
11 defined in the contract do not result in the utility's ratepayers subsidizing the operations of the
12 Construction Company by paying for services that are in excess of fair market price. In order
13 to fully evaluate the relationship of Central Rivers with the Construction Company, Staff
14 would need to obtain the necessary cost justification and support to determine if Central
15 Rivers is being excessively charged for the equipment and services provided by its affiliated
16 Construction Company.

17 Q. Are customers of Central Rivers being overcharged by the Construction
18 Company?

19 A. Potentially, yes. While the Construction Company provides equipment and
20 services to Central Rivers, it also provides equipment and services directly to Central Rivers'
21 customers through a tariff provision to construct and install STEP systems and pressure
22 service sewers on each of the customers' premises. These sewer system components are to
23 be owned by the customers, in accordance with tariff rules as described by Staff witness

1 James A. Merciel. Staff has requested information to evaluate the costs of the STEP system
2 installations but to date, the Construction Company has refused to provide all of the actual
3 costs for STEP system construction and installations.

4 Due to the common ownership of Central Rivers and the Construction Company, the
5 Construction Company is effectively the sole installer of the STEP systems and service
6 sewers for Central Rivers' customers. Also because of the common ownership, Staff
7 considers the payments from Central Rivers to the Construction Company for the said
8 installations to be affiliated transactions. Central Rivers did not provide the necessary cost
9 support for the STEP system and service sewer construction and installation activities,
10 because the utility does not require the Construction Company to provide detailed
11 descriptions of the costs to provide this service to utility customers. Central Rivers allows the
12 Construction Company to be the sole provider of this construction and installation service
13 without any competition from non-affiliated companies, even though customers have the right
14 to seek this service from non-affiliated companies as provision of the tariff.

15 Q. Are the Construction Company's employees performing the services charged
16 to Central Rivers related to the owner of the utility?

17 A. Yes. The Construction Company is a family business and to the best of my
18 knowledge, a list of its employees, their duties for Central Rivers, and their relationship to the
19 owner of the utility are as follows:

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22
23
24 *continued on next page*

1

Employees of Construction Services and Management, LLC		
Name	Duties	Relationship to Utility Owner
Mark Geisinger	Owner, Managerial	Self
Bill Geisinger	Operations	Father
Delores Geisinger	Annual Report	Mother
Alysia Meek	Administrative	Daughter
Luke Geisinger	Managerial	Son
Issac Geisinger	Operations	Son

2

3 All of the costs relating to the owner's family members are unsubstantiated, and the amounts
4 charged to Central Rivers for these services by the Construction Company are not based upon
5 the actual time spent in providing the services.

6 Q. Is it uncommon to have relatives perform services to operate a water or
7 sewer service?

8 A. No. What is unusual is for the utility company to have no employees and an
9 owner that provides no direct services to the utility. Under the circumstances where a utility
10 owner is directly active in the utility's operations and has relatives working at the company,
11 Staff is typically able to evaluate the employee's actual salaries and related costs and the work
12 performed to make a recommendation for those salaries. Staff can also typically determine
13 that no profit markup is being made above the actual costs for the services the related
14 (or unrelated) employees are providing. Because of the arrangement between Central
15 Rivers and the commonly owned Construction Company, Staff has been unable to make
16 these evaluations.

1 It is also unusual to have the type of arrangement where Central Rivers provides none
2 of the normal utility operations to its customers but contracts 100% of the services to the
3 commonly owned Construction Company. It is highly unusual for a utility company not to be
4 able to support and justify an overwhelming majority of its expenses during a rate case,
5 particularly costs related to salaries and equipment costs. In situations where outside
6 operators are used, the provided services are typically negotiated between arms-length
7 businesses and are not affiliated. Those contracts can be compared to similar contracts for
8 cost evaluation. That is not the case with the contract for the services the affiliated
9 Construction Company is providing to Central Rivers.

10 Q. In general, how did Staff evaluate whether the monies being paid to the
11 Construction Company were representative of an arms-length transaction?

12 A. Staff submitted several data requests to Central Rivers during the discovery
13 period in an attempt to determine if the charges being invoiced to Central Rivers by the
14 affiliated Construction Company were reasonable. The subject matter of the data requested
15 included the following:

- 16 • invoices sent to Central Rivers by the Construction Company
- 17 • an explanation of how the charges in the contract were formulated
- 18 • documentation that supported the actual costs for the installation of STEP units
- 19 • revenues collected by the Construction Company from other entities as well as
20 Central Rivers
- 21 • the actual number of hours spent by employees of the Construction Company
22 while performing clerical, managerial, and operational services for Central Rivers
- 23 • support for the hourly rates charged to Central Rivers by the employees of the
24 Construction Company
- 25 • payroll records for the employees of the Construction Company, and
- 26 • profit and loss statements for the Construction Company.

27 Q. How did the Company respond to the data requests for invoices sent to Central
28 Rivers by the Construction Company?

1 A. The Company provided a general description in the responses that pertained to
2 the costs that are invoiced by the Construction Company to run the utility, but Central Rivers
3 was unable or unwilling to provide adequate cost justification for the expenses booked to the
4 utility accounts. Throughout the entire audit process, Central Rivers did not provide sufficient
5 support for the costs the Construction Company charged Central Rivers for the services the
6 affiliate provided for sewer operations.

7 Q. How did the invoices from the Construction Company fail to provide adequate
8 support?

9 A. While Central Rivers received “invoices” from the Construction Company for
10 services provided by an affiliate entity, these invoices did not provide sufficient and adequate
11 detail which is necessary to substantiate costs for rate determination. Shown on the next page
12 is a sample of an invoice received by Central Rivers from the Construction Company:

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21
22
23 *continued on next page*

CONSTRUCTION SERVICES & MANAGEMENT
LLC
10040 Rock Falls Rd
Orrick, MO 64077

Invoice

Date Invoice #
4/30/2012 Apr Service

Bill To
Central Rivers Waste Water Utility, Inc
CRWW

PAID
10/25/2012

Description	Amount
Seven Service Calls	1,050.00
Replace Motor Float	48.00

Total \$1,098.00

1
2 This invoice is an example of the insufficient detail the Company used to justify their
3 expenses. The invoices from the Construction Company do not provide several types of
4 information such as job locations, time spent per employee, dates the service was performed,
5 the reason that each service was needed, etc. This information is required during an audit to
6 ensure the Construction Company is not “forcing” excessive costs onto the utility through the
7 owner’s dual control of both companies.

8 In Staff’s opinion, the only reason the level of detail reflected in the invoices from
9 the Construction Company to Central Rivers is considered sufficient by the Company is
10 because it is an affiliated transaction. It is very likely that if Central Rivers had received
11 an invoice exactly like this from an unaffiliated company, the utility would find the invoice to
12 be unacceptable.

13 Q. What about the data requests pertaining to the operations of the Construction
14 Company?

15 A. For the most part, the Company’s responses to Staff data requests omitted all
16 information about the revenues collected and expenses incurred between the Construction
17 Company and 3rd party entities. Additionally, the Company responded to the data requests
18 that requested information concerning the financial performance and employee detail of the
19 Construction Company by claiming, “Central Rivers Wastewater Utility, Inc. does not have
20 access to that information.” Examples of these responses by the Company are the responses
21 to Staff Data Requests Nos. 15 and 19, found in Schedules MRY-5 and MRY-6 respectively.

22 Q. Do you believe that Central Rivers is actually unable to access the books and
23 records of the Construction Company?

1 A. No. As I have previously mentioned, the owner of the Central Rivers is the
2 same individual who owns the Construction Company; therefore, Central Rivers' owner is
3 able to access the information at his leisure. Central Rivers simply refused to provide the
4 information requested by Staff to form a recommendation on the appropriate level of costs to
5 provide sewer service. In Staff's opinion, the Construction Company believes it is under no
6 obligation to provide any cost justification because it is not a regulated entity; therefore,
7 Central Rivers does not have to satisfy its obligation to support its cost of service.

8 Central Rivers' management allows the Construction Company management (the
9 same individual) to conduct utility business (including utility operations, maintenance, and
10 STEP construction) without the Construction Company producing detailed cost support to
11 provide to Central Rivers. The Construction Company's decision to outsource utility general
12 operations and STEP installations to the Construction Company created this situation and the
13 business practice of incurring unsupported costs does not allow for the support of costs for
14 rate determination, since the Company cannot provide auditable justification.

15 Q. Can Staff determine if the Construction Company is adding a profit mark-up to
16 the costs charged Central Rivers based upon the information available to it during the rate
17 case audit?

18 A. No, but Staff is very concerned that this is the case. If Central Rivers had its
19 own employees there would be actual costs that Staff could evaluate to determine if the
20 salaries and costs were proper. Certainly there would not be a profit margin added on top of
21 the actual costs. Due to actual cost documentation not being provided for review, Staff is
22 unable to substantiate the costs being charged to the utility through the affiliated contract
23 arrangement with the Construction Company. Further, Staff is unable to substantiate and

1 support the costs being directly charged to utility customers through the tariff provision of the
2 STEP system installations.

3 Q. Since the Construction Company is not a regulated company, is it excluded
4 from review during a rate case proceeding?

5 A. Certainly the transactions between the Construction Company and the
6 affiliated utility should be fully subject to review. As I discussed while explaining why the
7 Construction Company and its owner are affiliated to Central Rivers, the owner of the
8 Construction Company has direct control over the utility, including management decisions on
9 80% of the utility's expenses as well as revenues, and operations. This simultaneous and
10 substantial control over both a non-regulated company and a regulated utility creates a
11 substantial inherent risk because of the size and number of affiliated transactions.

12 When a company files for a rate increase, it has the responsibility to justify and
13 support its costs and demonstrate that those costs are just and reasonable. In a rate request,
14 the company has what is termed the "burden of proof" to support its cost structure. From my
15 understanding, the burden of proof obligation especially applies to affiliated transactions in
16 order to assure the affiliated parties are not engaging in incurring higher costs than what the
17 costs should be and do not create an undue financial burden for the ratepayers. In other
18 words, the utility is obligated to show that customers are not being overcharged for the utility
19 services or being overcharged for the STEP and service sewer installations.

20 In order to justify Central Rivers' costs incurred by contracting with the Construction
21 Company, Central Rivers needs to provide sufficient and auditable evidence to show that the
22 costs paid to the Construction Company are reasonable and prudent and excess costs are not
23 passed on to the utility's captive customers.

1 Q. What types of costs did Central Rivers fail to justify?

2 A. All costs listed in the contract are affiliated costs that are calculated using
3 unsupported assertions. In response to Data Request No. 4, the Company stated that the
4 charges shown in the contract were formulated as follows:
5

Description of Service	Number of Hours Required per Period	Construction Company's Hourly Rate	Total Charge
Service Call	As Needed	\$150 1 st hr. \$60 addtl hrs	Varies
Maintenance	27.5	\$60	\$1,650 /month
Customer STEP Maint	2 (per STEP)	\$60	\$120 /STEP
Mowing	5	\$60	\$300 /plant /month
Clerical	46.4	\$35	\$1,625 /month
Management	12	\$75	\$900 /month
Monitoring	32	\$60	\$1,920 /month
Cleaning	21	\$60	\$1,260 /quarter

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7 Since Central Rivers did not provide support to justify how much actual time the
8 employees of the Construction Company spend on performing utility functions, all of the
9 charges shown in the contract that are based on hourly rates are unsupported. In addition,
10 Staff is unable to determine if the Construction Company used an excessive profit margin as a
11 component of the hourly rates of each service provided to the utility and directly or indirectly
12 charged the utility customers.

13 The only charge in the contract that the Construction Company did not calculate by
14 multiplying their hourly rates by the unsupported number of hours is the charge to install a
15 STEP unit and service sewer, which is identified as STEP unit installations. The STEP
16 installation fee is a flat rate for each installation. I will discuss the STEP installation fee in the
17 rate base section of this testimony. Also, for additional information on STEP installations,
18 please refer to the direct testimony of Staff witness James A. Merciel.

1 Q. You have made several references to arms-length transactions and market
2 values. Does market value have a role in the rate making process?

3 A. Yes it does. According to economists Jonathan A. Lesser Ph.D. and Leonardo
4 R. Giacchino, Ph.D. (2013), market value has everything to do with establishing rates for
5 public utilities. Their economic goal of regulation is the following²:

6 The fundamental economic goal of regulation is
7 straightforward: *to mimic a competitive market outcome, even*
8 *when the underlying market is not competitive.* In other words,
9 purely economic regulation strives to achieve outcomes that
10 capture the benefits of competitive markets when those markets
11 are themselves not competitive.

12 Q. Since Central Rivers did not provide the information necessary to compare
13 the contractual charges to the market value of the services provided, how did you proceed in
14 your audit?

15 A. I attempted to recreate the process a competitive firm might use while it is
16 establishing hourly rates it would charge clients for the time of each employee. I then applied
17 this process to Central Rivers using the information supplied by the Company combined with
18 appropriate market wages obtained from other sources. Lastly, I compared the charges for
19 each service that the Construction Company is charging to Central Rivers to the results of my
20 calculations. In other words, I performed an analysis to compare the charges listed in the
21 contract with a recalculation of those charges based on the market value of wages.

22 Q. You said you obtained data from other sources for purposes of your analysis.
23 Would it have been preferable to use actual data from the Construction Company?

24 A. Yes. Using actual cost information would have been preferable because it
25 would have increased the accuracy of the ratios based on the Construction Company's payroll

² Lesser, Jonathan A, Giacchino, Leonardo R. *Fundamentals of Energy Regulation: Public Utilities Reports, Inc,* 2013, 2nd edition.

1 and overhead expenses. However, the data required is kept in the books and records of the
2 Construction Company, which was requested from but not provided by Central Rivers. Using
3 actual cost information is what Staff typically uses to develop its cost of service
4 recommendations but in this case, I had to rely on other sources which I will describe in the
5 “Expenses” section of this testimony.

6 Q. Should the Commission require Central Rivers to support its use of the
7 affiliated Construction Company?

8 A. Yes. Central Rivers should support its use of affiliated Construction Company
9 as the sole provider of the equipment and services to the utility operations and require the
10 utility to support its costs requested in this and future rate cases used to determine rates
11 charged its utility customers. In addition, Central Rivers should support its decision to allow
12 the affiliated Construction Company to be the sole provider of the installation of the STEP
13 systems on the utility customers’ premises.

14 **IV. EXPENSES**

15 Q. You indicated you made a comparison of the charges in the contract with a
16 calculation of those charges based on the market value of wages. What were the results of this
17 analysis?

18 A. My analysis, attached to this direct testimony as Schedule MRY-4, shows that
19 the costs that are being invoiced to Central Rivers exceed a calculated market value for
20 those services.

21 Q. With reference to the Schedule MRY-4, what is the purpose for each column in
22 the table, and please provide an explanation of what each column represents and identify any
23 assumptions used for the cost determination?

1 A. Column A identifies the itemized services the Construction Company performs
2 for Central Rivers. A description of each of these services can be found in the contract,
3 attached as Schedule MRY-2. Note that if you compared column A to the contract, you will
4 notice that the line item for STEP installation is not included in this analysis. I omitted this
5 service from the expense analysis because these costs are capital in nature and the
6 appropriate accounting treatment is to capitalize the STEP installations as contributed plant.
7 I will discuss this accounting treatment for STEP installations further in the rate base section
8 of this testimony.

9 Column B represents wage rates found on the Missouri Economic Research and
10 Information Center (“MERIC”) website. MERIC is a research division of the Missouri
11 Department of Economic Development that provides labor market information and is
12 commonly used by Staff in small water and sewer cases to compare wage rates for various
13 utility services. The information on the website is produced by research done in cooperation
14 with the Missouri Department of Labor and the site provides Missouri labor rates by areas of
15 the state for various job classifications. Using the online database, I found the Kansas City
16 region’s market value hourly rates for three types of employees: 1) Manager, 2) Billing and
17 Posting Clerk, and 3) Water and Wastewater Treatment Plant and System Operator.

18 Column C is the number of hours allocated by the Construction Company for each
19 service annually. Note that the Construction Company has not maintained timecards or other
20 appropriate records so the numbers in this column are unsupported estimates. Also note that
21 the allocated number of hours for Mowing reflects that the service is performed for 7 months
22 per year instead of a full 12 months.

1 Column D is an overhead markup factor designed to increase the hourly rate in order
2 to cover the Construction Company's overhead expenses. For example, if the Construction
3 Company incurred a total annual expense of \$100 and payroll costs consisted of \$60, the
4 overhead markup factor would equal 1.67 ($\$100/\60). After the factor is calculated, rates can
5 be set for individual company employees based on their hourly pay rate. For instance, an
6 employee earning \$2 per hour would charge a client \$3.34 per hour ($\$2 * 1.67$). The charge
7 theoretically produces revenues sufficient to cover the cost of the employee's payroll, payroll
8 related costs as well as the company's other overhead costs. My original intent was to
9 calculate a markup factor that represented the actual overhead costs of the Construction
10 Company. However, Central Rivers did not supply actual data concerning overhead costs, so
11 I used a conservative markup factor of 1.5.

12 Column E recognizes that firms, including the Construction Company, desire to
13 produce revenues that exceed expenses in order to create a profit margin. Once again, I hoped
14 to use the Construction Company's historical profits in this analysis but the data was not
15 supplied. As an alternative, a 9.04% profit markup was used. This percentage is what Staff
16 found to be an appropriate rate of return for the utility.

17 Column F represents the product of columns B, C, D, and E. This column calculates
18 the total amount the Construction Company should charge to Central Rivers assuming all of
19 the inputs are correct. Note that the total test year amount of \$3,875 for Service Calls was
20 used in substitution of columns B and C.

21 Column G is the total amounts the Central Rivers has agreed to pay the Construction
22 Company annually. Again, the total for Service Calls is the test year total and the expense for
23 Mowing is for 7 months of the year.

1 Column H reflects the difference between the contractual expenses and the total
2 expenses calculated using the market value of wages.

3 Q. Your analysis shows that the contract exceeds the market value for the services
4 by a substantial amount. Does your analysis show that the costs charged to Central Rivers by
5 the Construction Company are reasonable?

6 A. No, this analysis does not show the costs charged by the Construction
7 Company to Central Rivers are reasonable. Even under the assumption that the time required
8 to perform the services required by the contract is accurate, the analysis shows that the grand
9 total of the contractual charges provide the Construction Company an opportunity to 1) pay its
10 employees' a level of wages that exceed market value, 2) earn a profit that exceeds a fair rate
11 of return in the utility industry or 3) both.

12 Q. Is the execution of the contract between Central Rivers and the Construction
13 Company considered an "arms-length transaction"?

14 A. No. It is not possible for this contract to be considered an arm-length
15 negotiated contract since the two entities are owned by the same individual. In essence, the
16 owner of Central Rivers negotiated with himself as the owner of the Construction Company.

17 Q. If all of the assumptions made by Staff during the audit were accurate, what
18 would Staff recommend related to the expenses paid by Central Rivers to the Construction
19 Company?

20 A. Even though the sum of the charges in the contract exceed the amount that
21 I calculated as the market value of the services, the total dollars Central Rivers paid to the
22 Construction Company during the test year approximated the results of my analysis. During a
23 discussion with Company management, Staff inquired why the test year expenses were below

1 the amounts defined in the contract. Central Rivers stated the reason that the test year
2 expenses paid to the Construction Company did not meet the contracted amounts was that the
3 utility was not earning enough revenue to pay all of the amounts invoiced by the Construction
4 Company.

5 In response to Data Request No. 15, attached as Schedule MRY-5, the Company
6 claimed that utility revenues had been insufficient to satisfy the invoices from the
7 Construction Company since at least 2011. According to management, Central Rivers
8 currently has an unpaid balance of \$198,260 owed to the Construction Company. Since the
9 utility has been unable to justify that any of the costs invoiced by the Construction Company
10 are reasonable and prudent, Staff cannot recognize the unpaid balance of those costs.

11 Since the test year expense approximated the market value shown in the analysis, no
12 adjustments to the test year were made in Staff's EMS run. In other words, Staff maintained
13 the test year balances for payments to the Construction Company in the cost of service
14 calculation with one exception that will be discussed later.

15 Q. By basing its expense allowance for Central Rivers in this case primarily on
16 the amount paid to the Construction Company in the test year, is Staff making any
17 representation that actual amounts paid to the affiliated entity in the test year are prudent and
18 reasonable in amount?

19 A. No. It is a merely a coincidence that the amount of the payments made by
20 Central Rivers to the Construction Company approximates what Staff has calculated a
21 reasonable allowance for the associated expenses might be if the allocated hours for each
22 service was accurate. Of course, if Central Rivers would have paid the full amount charged to
23 it by the Construction Company in the test year, its expenses on its books would have been

1 significantly higher. Neither the amount of payments made by Central Rivers to its affiliate
2 or the total amount charged to the utility by the affiliate are appropriate to incorporate into
3 rates at this time absent adequate supporting documentation.

4 Q. What is the exception to the amounts included as an expense to the
5 Construction Company that was not a part of the test year?

6 A. After the test year, the Department of Natural Resources imposed additional
7 maintenance requirements on Central Rivers. Since the related costs were not in the test year
8 but the additional requirements were known to be in effect, Staff included a calculated
9 estimate of the additional costs that would be necessary for the Company to stay in
10 compliance.

11 Q. What is the total amount of expenses in Staff's cost of service calculation for
12 the services provided by the Construction Company?

13 A. This amount is approximately \$100,000 annually.

14 Q. Did Staff make any other adjustments to the Company's expenses?

15 A. Yes. Here is a brief summary of the remaining adjustments:

- 16 • Non-recurring legal expense was normalized over a five year period
- 17 • Software and communications expenses were removed. Staff considered these
- 18 expenses to be embedded in the administrative services provided by the
- 19 Construction Company
- 20 • Adjusted the Missouri Public Service Commission Assessment to the last
- 21 known amount
- 22 • Adjustments to update the contributions in aid of construction ("CIAC")
- 23 amortization expense (depreciation offset).

24 **V. REVENUES**

25 Q. How did you annualize revenues in the cost of service calculation?

26 A. I annualized revenues based on the three types of income the Company is
27 collecting:

- 1 1) The current fixed charge of \$32 billed each month to the update period of 241
2 customers,
3 2) The test year balance of late-fee revenues, and
4 3) An Empty Lot Fee of a fixed \$20 per month billed to 56 lot owners.

5 Q. What is an “Empty Lot Fee?”

6 A. The Empty Lot Fees are charged to the owners of lots that are unimproved
7 (a structure has not been built) and do not have sewer collection equipment on the lot’s
8 premises, including a STEP system and service sewer installed or constructed. Therefore, the
9 owners of these lots are not utility customers of Central Rivers.

10 Q. Are these fees charged to developers who own the lots, or individuals who
11 have purchased a lot but have not yet built a residence?

12 A. Both. When Central Rivers constructs the collection system and a treatment
13 facility in a new subdivision, an agreement is made with the developer to pay the Company
14 \$20 per month for each empty lot. At the time the developer sells a lot to an individual, an
15 agreement is signed by the buyer during the sale that commits them to continue to pay the
16 Empty Lot Fee until sewer service is initiated. The result of this arrangement is that Central
17 Rivers collects \$20 per month per empty lot from the time the subdivision’s sewer collection
18 system is constructed to the time there are no more empty lots, no matter who the owner of
19 each parcel of land may be.

20 Q. Why did the Company begin to charge the Empty Lot Fees?

21 A. A majority of construction activity in new subdivisions, such as those in
22 Central Rivers’ service areas, are typically undertaken at one time. While other subdivision
23 development activities, such as the construction of streets, storm drainage, electric and water
24 infrastructure systems, are undertaken, Central Rivers installs the entire collection system and
25 the treatment facility, which is sized to serve the entire subdivision at full capacity. However,

1 between the time that the sewer collection system is constructed and the time that sewer
2 customers exist on all the lots in the subdivision and are connected to the sewer system, there
3 is a shortfall in revenue. The Company began to charge Empty Lot Fees to maintain revenue
4 sufficient to cover the cost of maintaining the underutilized plant.

5 Q. The Company's tariff does not establish an Empty Lot Fee, so why did Staff
6 include those fees in the Company's revenues?

7 A. Given that the sewer infrastructure maintained by Central Rivers is built to
8 serve subdivisions that, in total, contain approximately 26% lots that are not connected to the
9 sewer collection system, Staff annualized Empty Lot Fee revenue to offset the revenue
10 requirement that will be charged to users of the sewer system. Effectively, the Empty Lot
11 Fees allocate some of the maintenance cost to non-users of the sewer system because the cost
12 incurred from maintenance of the treatment facilities is independent of the number of sewer
13 users. No matter the number of customers, Central Rivers must maintain the entire collection
14 system, must maintain the sewage treatment facility, and must pay for the routine operations
15 checks for all customers—current and future. In other words, the capacity being utilized at
16 each subdivision's treatment facility, whether that is 10% or 100% of capacity, does not affect
17 the cost of maintaining that entire sewer system.

18 **VI. RATE BASE**

19 Q. Earlier, you stated that Staff made the decision to capitalize all costs
20 and revenues pertaining to STEP installations. Can you give further detail describing a
21 STEP installation?

22 A. Yes. When a lot owner commences with building a home, the lot owner is
23 required to call Central Rivers to arrange installation of the STEP system for their structure

1 and the related service sewer. Central Rivers then arranges for its affiliate, the Construction
2 Company, to install the equipment.

3 Q. After a STEP is installed, does Central Rivers retain ownership of the unit?

4 A. No. Each of Central Rivers' customers owns the STEP systems and service
5 sewers, after being billed by the Company for the construction and installation, per Central
6 Rivers' tariff, Sheet No. 32. After Central Rivers collects the STEP installation fee from the
7 customer, the Construction Company sends an invoice to the Company for the installation of
8 the STEP systems based on the contract between the two affiliated entities.

9 Q. So if the customer purchased and owns the STEP, why did Staff capitalize the
10 STEP units as part of Central Rivers' rate base?

11 A. Although the customer owns the physical STEP system and service sewer and
12 all components comprising the system, Central Rivers reserves the exclusive rights to
13 maintain, replace, and repair the equipment per the Company's tariff, Sheet No. 32.
14 Additionally, as a practical standpoint Central Rivers has been the exclusive installer through
15 its affiliate, the Construction Company, for the customer-owned STEP system and service
16 sewer. Since Central Rivers is the only entity that is responsible for installing and
17 maintaining STEP units, the revenues and expenses related to STEP installations are capital
18 in nature.

19 Q. Since the customer paid Central Rivers when they bought the STEP, does
20 Staff's recommendation allow the Company to earn a financial return on the amount that was
21 capitalized?

22 A. No. In the Company's rate base, Staff accounted for the cost of the STEP
23 installations as an addition to plant in service and accounted for the revenue received for

1 STEP installations as an increase to CIAC. The effect of the increase to CIAC totally
2 offset the addition to plant-in-service, resulting in a total rate base change of zero dollars. It
3 is important to ensure that the customers receive full credit for the total amount paid for
4 all STEP sewer systems. The additions to plant-in-service and CIAC are illustrated in
5 Schedule 2, of the EMS run.

6 Q. How much do the customers pay the Company for the installation of a
7 STEP unit?

8 A. At this time, the Company charges a new customer \$6,000 to install a
9 STEP unit.

10 Q. Does the current tariff for Central Rivers allow an installation charge of
11 that amount?

12 A. No. Sheet No. 14 of the Company's tariff states that the Company can charge
13 either \$4,500 or \$4,800 for each STEP installation for residential customers, depending upon
14 the number of bedrooms in the new home.

15 Q. Did you inquire why Central Rivers exceeded the tariffed rate in its current
16 STEP installation charges to customers?

17 A. Yes. During a discussion with Company management, Staff was advised that
18 since the tariff was established in 1999, the Construction Company's costs for the materials
19 necessary for a STEP installation had risen. As a result, the invoices received by Central
20 Rivers from the Construction Company increased in order to reimburse the Construction
21 Company for its increasing expenses. For each increase in costs Central Rivers incurred from
22 the Construction Company, Central Rivers made a corresponding increase of the fee charged
23 to its utility customers for a STEP installation. However, when Staff inquired why the

1 Company did not initiate a rate case to reflect the rising costs, Central Rivers had no
2 explanation why it decided, on its own, to ignore the need to seek approval to change a
3 Commission-approved tariff charge.

4 Q. Regardless of whether or not it sought approval to change a tariff-stated
5 charge, did the books and records of Central Rivers show that the costs for STEP installations
6 have increased?

7 A. No. Central Rivers did not have any documentation that supported the alleged
8 cost increases. The books and records of Central Rivers only show the amounts paid to the
9 Construction Company for each STEP installation, but the underlying support for costs
10 charged to Central Rivers and, ultimately its customers, was not provided by the Construction
11 Company. Those actual costs incurred to construct and install the STEP systems are only
12 reflected on the books of the Construction Company, and this information was not provided to
13 Staff to support an increase of the STEP installation fee.

14 Q. Did Staff ask the Company to provide support for the increased costs of the
15 STEP installation?

16 A. Yes. As I mentioned, Staff submitted discovery requests to Central Rivers to
17 obtain support for these costs from the Construction Company in the form of actual cost data
18 and documentation. The series of discovery requests and Company responses are attached to
19 this testimony as Schedule MRY-7.

20 Q. Did the Company respond to the data requests with actual data and
21 documentation?

22 A. No. In the Response to Data Request No. 13, Central Rivers submitted a price
23 quote from the Construction Company of what cost components are included in the \$6,000 the

1 Company is currently charging customers. Similar to the invoices described in the expenses
2 section of this testimony, the estimate provided by the Construction Company does not
3 provide adequate detail to support the cost increases. The price quote lacks sufficient detail
4 describing the services performed by the Construction Company and does not itemize costs
5 for this affiliated transaction. Therefore, this document was insufficient support for an
6 increase in the STEP installation fee.

7 Q. Did Staff follow up to the response to Data Request No. 13 in an attempt to
8 obtain more detailed information?

9 A. Yes. Staff submitted Data Request No. 13.1 which defined the type of
10 information that would be deemed an adequate response. This data request made clear Staff's
11 desire to review receipts and invoices showing actual costs for the STEP system installations.

12 Q. Did the Company respond to Data Request No. 13.1 with information that
13 supports actual costs?

14 A. Initially they did not. The Company's Response dated on July 28, 2014 stated
15 that the Company was working to collect supporting documentation and submitted a
16 document that gave a more detailed breakdown of each component's cost. However, this
17 document still listed estimated costs and was not sufficient to support the actual costs to
18 install STEP systems. Estimated costs do not provide sufficient information to support costs
19 for inclusion in this rate case and certainly does not provide sufficient information to support
20 the Central Rivers' proposed increase for the STEP system installations.

21 Q. Did the Company submit any supporting documentation that the response to
22 Data Request No. 13.1 referenced?

1 A. Yes. On September 24, 2014 Central Rivers submitted two types of supporting
2 documentation.

3 Q. What was the first type of documentation the Company offered in their
4 response to Data Request No. 13.1?

5 A. Central Rivers submitted quotes from two companies with the purported intent
6 of comparing the costs in the contract between the utility and the Construction Company,
7 including STEP installations, to what the costs would be if an entity other than the
8 Construction Company performed the same services. This information is also based on
9 estimates, not on actual costs to install the STEP systems.

10 Q. Do these bids give support of the cost of a STEP installation?

11 A. No. There are several reasons the bids do not support the costs of a STEP
12 installation. The following are some of the concerns Staff had with the price quotes:

- 13 • Staff is unsure if the companies are capable of performing the services in the
14 contract, specifically if they are qualified as on-site sewage treatment system
15 installers.
- 16 • The description of the services identifies 270 utility customers and this is a
17 material increase from the customer count of 241 identified by Staff. An
18 overstated customer count may lead to a misstatement of the price quote.
- 19 • Staff does not know if the companies have had any prior business or personal
20 dealings with Central Rivers, its ownership or Central Rivers' affiliate, the
21 Construction Company. An established relationship with the 3rd parties
22 renders the bids non-competitive and therefore meaningless.
- 23 • Lastly, the description of a STEP installation is very brief. A proper price
24 quote would need more information about the work required for the sake of
25 accuracy.

26 Q. What was the second type of documentation the Company offered in their
27 response to Data Request No. 13.1?

28 A. Central Rivers submitted copies of invoices and receipts supporting the
29 materials required to perform an actual installation. However, the Company was still lacking

1 support for the labor component of a STEP installation. According to the Company's
2 response, labor accounts for 37% of the total expenses. Staff found the labor expense to be
3 material since the source of the labor is the Company's affiliate, the Construction Company.

4 Q. What information would Staff consider acceptable to support the labor costs
5 for the STEP installation?

6 A. When Staff examines the reasonableness of labor costs, especially in an
7 affiliated transaction, required documentation would include but not be limited to:

- 8 • a description of each duty performed
- 9 • actual time spent performing those duties
- 10 • the dates and location of the work
- 11 • invoices describing the actual work or services being provided from an
- 12 unrelated 3rd party supporting actual costs for the expenses (plumbers,
- 13 electricians, equipment rental, etc.),
- 14 • the type of equipment used
- 15 • how much time each piece of equipment was used, and
- 16 • the rates charged for the equipment including any transportation and set
- 17 charges for the equipment.

18 Q. Why does Staff need to examine all of those factors components of STEP
19 installation?

20 A. In any rate case, one of the information sources Staff will examine is the
21 historical cost information in order to determine if an adjustment should be applied to that
22 cost. Staff attempted to make the same examination in this case for the cost related to STEP
23 installations with the understanding that STEP installation are not routine and no two
24 installations will be the same. In order to determine a fair STEP installation fee, Staff needs
25 to examine *all* components of the installation costs, including labor. Furthermore, Staff needs
26 to examine the cost of not just one STEP installation, but many STEP installations.

1 Q. Why wouldn't Staff be able to justify costs based on one STEP installation?

2 A. As indicated earlier, no two installations are the same. Consider the following
3 scenarios that display why cost components may change for each STEP installation:

- 4 • STEP installation A may require less piping than STEP installation B, resulting
5 in a variable cost of materials.
- 6 • STEP installation C may take more time to complete than STEP installation D
7 resulting in a variable cost of labor.
- 8 • STEP installation E may be located in soil with more rocks than STEP
9 installation F resulting in a variable cost of backhoe rental.

10 Q. What is Staff's position on the Company's request to increase the tariffed
11 connection fee to \$6,000?

12 A. Staff witness Merciel is addressing this in his direct testimony. Mr. Merciel
13 states it is Staff's position that Central Rivers has not provided enough support to justify an
14 increase in the STEP installation fee.

15 Q. What is Staff's proposal for the STEP installation fee going forward?

16 A. Staff is proposing that the tariffed fee remain at the existing \$4,500 and \$4,800
17 for all residential STEP installations based on number of bedrooms in the residential
18 customer's premises. Since Staff has been unable to obtain historical actual cost information,
19 any increase in the tariffed STEP installation fee has not been justified by the Company.

20 Q. According to the direct testimony of Staff witness Merciel, Staff is
21 recommending that the Commission order the Company to refund all STEP installation fees in
22 excess of the tariffed amounts to the individual customers. If the Commission approved
23 Staff's recommendation, would this order have an effect on the Company's rate base?

24 A. Not in this case. If Central Rivers had supported the actual historical costs for
25 the STEP installations already performed to date, refunds of over-collected installation fees
26 would be accounted for as a reduction to CIAC. A reduction to CIAC would increase rate

1 base by the amounts refunded. However, despite repeated attempts by Staff to obtain the
2 actual historical cost information, including Data Requests, emails, and conference calls, the
3 Company has not supported the historical costs incurred from the installation of STEP
4 systems, so Staff cannot accurately quantify the Company's investment in rate base.

5 Q. If the Commission approves that the STEP installation fee remain as currently
6 defined in the Company's tariff, but the actual costs to perform this service is rising as the
7 Company has claimed, would Staff recognize the rising costs in future rate cases?

8 A. In any rate case, the Company has the responsibility to support the actual costs
9 to provide utility service. Staff would not recognize costs without the proper documentation
10 of those costs.

11 Q. What kind of documentation would be required for future STEP installations?

12 A. Adequate audit supporting documentation for STEP installations would
13 include but not be limited to the following:

- 14 • Receipts and invoices that identifies the materials, separated by STEP
15 installation and related costs for those materials
- 16 • Receipts and invoices from unrelated 3rd parties (i.e. plumbers, electricians)
- 17 • A copy of the check received from each new customer to support the proper
18 amount of CIAC
- 19 • Timecards from each employee of the Construction Company involved with a
20 STEP installation, including description of duties performed and actual labor
21 costs
- 22 • Increased detail in the invoices from the Construction Company, including:
 - 23 ○ location of the STEP installation
 - 24 ○ a description of the services provided and related costs
 - 25 ○ actual time required to perform each service and actual labor costs for each
26 service provided
 - 27 ○ equipment used and related equipment charges including, any related
28 charges such as transportation and setup costs
 - 29 ○ actual time required to operate each piece of equipment and related
30 operator costs

1 Q. In general, if the Company maintains and provides to Staff sufficient
2 documentation relating to STEP installations, will future transactions be reflected in
3 rate base?

4 A. Yes. *Under the assumption* that the Company will maintain and provide
5 sufficient documentation supporting the actual costs of each STEP installation going forward,
6 any *reasonable* cost incurred in excess of the monies collected from ratepayers and/or
7 developers will be considered as an investment by Central Rivers and will be eligible to be
8 included in rate base. The requirement for support of costs is typical for Staff while
9 examining any investment in property, plant, and equipment. Furthermore, the requirement
10 for supporting documentation not only applies to future STEP installations, but also to other
11 future investments of the Company, including investments in additional collection sewers and
12 treatment facilities.

13 Q. Was there another rate base issue?

14 A. Yes. The Company has been collecting customer deposits for each new
15 customer. Once the customer deposits were collected, Central Rivers held those funds until
16 the time the customer moved out and disconnected sewer service. This practice is opposed to
17 refunding the deposits after a one year period. Additionally, the Company did not refund
18 accrued interest on the deposits held as the current tariff states on Sheet No. 38.

19 Q. Has a resolution on this issue been reached?

20 A. Partially. During the course of the audit, all parties agreed that the Company
21 should refund all customer deposits, with accrued interest³, and cease to collect them going
22 forward. The only issue remaining is the time period in which to complete the deposit refund.

³ Because the Company has been holding deposits for several years, accruing interest using the compound interest method would be a financial hardship on the Company and a minimal financial interest to each

1 Q. What time period does Staff propose?

2 A. Staff proposes that the customer deposits should be refunded over a 24 month
3 period. A refund period of 24 months would not be a financial burden for the Company.

4 **VII. CONCLUSION AND RECOMMENDATION**

5 Q. What is Staff's overall recommendation in this case?

6 A. Staff is recommending that no rate or fee increase be authorized by the
7 Commission because Central Rivers is unable to support its rate increase request with actual
8 cost information in support of its cost of service. By virtue of the corporate structure of
9 Central Rivers and its affiliation with the Construction Company, the utility does not have the
10 authority to make decisions regarding the operations of the regulated sewer systems. Since
11 Central Rivers cannot make decisions for the utility, it cannot represent the interests of the
12 Company or defend against decisions made by the Construction Company.

13 As such, Central Rivers was unable to provide the necessary cost justification to
14 support the requested rate increase because the Construction Company made the decision to
15 refuse to provide this information. While Staff was able to develop an estimate of what a rate
16 increase would be if calculated in a normal manner, Staff had to make many assumptions
17 regarding what costs Central Rivers would incur to operate the sewer systems as part of that
18 calculation. The revenue requirement identified in the EMS run should not be relied upon
19 because it was based on the cost estimates and assumptions that are not supported by actual
20 costs to operate the sewer system. Since actual cost information was not provided because the
21 owner refused to provide this information, Staff does not support a rate increase be granted to
22 Central Rivers in this case.

individual customer. Staff proposes to use a simple interest method when calculating the interest due to each customer.

Direct Testimony of
Matthew R. Young

1 Central Rivers should be required to refund to customers monies paid for the STEP
2 installations above the authorized tariff amounts.

3 Central Rivers should be required to refund the monies related to customer deposits.
4 The Company should discontinue the practice of collecting customer deposits in the future.

5 Q. Does this conclude your direct testimony?

6 A. Yes, it does.

Educational and Employment Background and Credentials

I am currently employed as a Utility Regulatory Auditor II for the Missouri Public Service Commission (Commission) within the auditing unit. I earned a Bachelor of Liberal Arts from The University of Missouri – Kansas City in May 2009 and a Master of Science in Accounting, also from The University of Missouri – Kansas City, in December 2011. I have been employed by the Commission since July 2013.

As a Utility Regulatory Auditor, I perform rate audits and prepare miscellaneous filings for consideration by the Commission. In addition, I review all exhibits and testimony on assigned issues, develop accounting adjustments and issue positions which are supported by workpapers and written testimony. For cases that do not require prepared testimony, I prepare Staff Recommendation Memorandums.

Cases in which I have participated and the subject matter of my audits are listed below:

Case/Tracking Number	Company Name- Type of Case - Issues
GR-2015-0026	Laclede Gas Company – ISRS; Plant Additions and Retirements, Contributions in Aid of Construction.
GR-2015-0025	Missouri Gas Energy – ISRS; Plant Additions and Retirements, Contributions in Aid of Construction.
WR-2015-0020	Gascony Water Company – Rate Case; Revenues and Expenses, Rate Base.
SM-2015-0014	Raccoon Creek Utility Operating Company – Sale Case; Rate Base, Acquisition Premium.
SR-2014-0247	Central River Wastewater Utility – Rate Case; Revenues and Expenses, Rate Base, Affiliated Transactions.
HR-2014-0066	Veolia Energy Kansas City – Rate Case; Payroll, Payroll Benefits, Payroll Taxes, Bonus Compensation, Property Taxes, Insurance Expense, Injuries & Damages Expense, Outside Services, Rate Case Expense.
GO-2014-0179	Missouri Gas Energy – ISRS; Plant Additions, Contributions in Aid of Construction.
GR-2014-0007	Missouri Gas Energy – Rate Case; Advertising & Promotional Items, Dues and Donations, Lobbying Expense, Miscellaneous

Matthew R. Young

	Expenses, PSC Assessment, Plant in Service, Depreciation Expense, Depreciation Reserve, Prepayments, Materials & Supplies, Customer Advances, Customer Deposits, Interest on Customer Deposits.
SA-2014-0005	Central Rivers Wastewater Utility – Certificate Case; Revenue and Expenses, Plant in Service, Depreciation Reserve. Other Rate Base Items.

January 1, 2014

Mr. Mark Geisinger, President
Central Rivers Wastewater Utility, Inc.
P.O. Box 528
Kearney, Missouri 64060

2014 SERVICE CONTRACT

Thank you for asking Construction Services & Management to provide this proposal for services for the maintenance of Central Rivers Wastewater Utility's sewer plants. CS&M will provide these service with qualified service technicians and an MDNR Class A wastewater operator, Mark Geisinger and an MDNR Class C wastewater operator, Isaac Geisinger. We understand the sewer plants to be as follows:

- Berkshire Glen
- Country Hill Estates
- Countryside Meadows
- Fox Run
- Park Estates
- Private Gardens
- Wilmar Estates

SCOPE OF SERVICES

Construction Services & Management proposes to provide the following scope of services for the above sewer plants:

1. Provide services calls on an as-needed basis.
2. Monthly monitoring and maintenance of sewer plants. This includes a weekly visit to the facility, cleaning filters, checking control panels and alarms, drawing of water samples, delivery of samples to lab, and sending reports for each plant to DNR.
3. Yearly cleaning and inspection of each customer's collection equipment. This includes all customers in all subdivisions listed above.
4. Monthly mowing and weed control of all sewer plants during the mowing season.
5. Monthly clerical duties, including all accounts receivable tasks. This also includes office and equipment expenses.
6. Monthly management.
7. Installation of collection equipment and connection to main within subdivision for each new customer connection.
8. Monthly monitoring of Wilmar and Private Gardens. An increase of services for new operational guidelines. These two subdivisions fall under guidelines designated by DNR for systems operated above 200 P.E. This will require a daily visit by our Class C operator at each location.
9. Quarterly cleaning of filters and sand filter piping at sewer plants.

FEES

Construction Services & Management proposes to provide the above scope of services for the following fees:

1. Service call – \$150 first hour, \$60 for each additional hour
2. Monthly maintenance of sewer plants – \$1,650.00
3. Yearly cleaning and inspection of each customer's collection equipment – per customer \$120.00
4. Monthly mowing of sewer plants – per plant - \$300.00
5. Monthly clerical duties – \$1,625.00
6. Monthly management – \$900.00
7. Install collection equipment and connect to main – per customer \$6,000.00
8. Additional monthly services for Private Gardens and Wilmar monitoring – \$1,920.00
9. Quarterly cleaning – \$1,260.00

We look forward to working with you. If you have any questions or comments please feel free to contact me. If these terms are agreeable please sign and return one copy for our files.

Submitted By:

CONSTRUCTION SERVICES & MANAGEMENT, LLC



Bill Geisinger

Manager

Accepted By:

CENTRAL RIVERS WASTEWATER UTILITY, INC.



Signature

01/01/2014
Date

STAFF MEMORANDUM

To: Committee on Governmental Affairs
Members and Staff

From: Majority Staff

Date: November 12, 2002

Subject: Committee Staff Investigation of the Federal Energy Regulatory Commission’s Oversight of Enron Corp.

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INTRODUCTION

On December 2, 2001, Enron, then ranked as the nation's seventh largest company, filed for federal bankruptcy protection amid allegations of far reaching financial and other fraud. Enron's collapse left thousands of employees without jobs and with severely diminished retirement savings and erased billions of dollars of shareholder value. Perhaps most significantly, it triggered a crisis of investor confidence in U.S. financial markets – and a concomitant crisis in ratepayer and investor confidence in the energy markets. Enron's meltdown has had effects that have reverberated through the energy sector as well as other parts of the U.S. economy, and its consequences continue to be felt today.

In January 2002, the Senate Committee on Governmental Affairs undertook an investigation into the collapse of Enron. Specifically, the Committee examined a variety of public and private entities that had responsibility for overseeing or monitoring aspects of Enron's activities and protecting the public against the type of calamities that resulted. The charge was to seek to determine if these watchdogs did their jobs correctly and whether they could have done anything to prevent, or at least detect earlier, the problems that led to Enron's failure. Among the entities looked at closely by the Committee has been the Federal Energy Regulatory Commission (FERC), the government's primary energy regulator. Although Enron, at the end, was involved in an assortment of far-flung activities, at its core, Enron was an energy company, and many of its activities were subject to direct or indirect oversight by FERC.

The Committee initiated its investigation through letters sent to the FERC Chairman on February 15 and March 27, 2002, requesting information about FERC's dealings with Enron and its affiliates over the last ten years, information which FERC provided to the Committee. The Committee also made follow-up requests to FERC for further information concerning investigations, inquiries, and audits involving Enron subsidiaries and affiliates. In addition, Committee staff had a number of interviews and discussions with FERC staff, officials of other federal agencies, and non-Enron utility company employees concerning the specific matters discussed in this memo. Committee staff also reviewed thousands of documents and e-mail records from Enron and affiliated companies provided to the Committee and to its Permanent Subcommittee on Investigations in response to subpoenas to Enron.

What Committee staff for the majority found was an agency that was no match for a determined Enron and that has yet to prove that it is up to the challenge of proactively overseeing changing markets. On a number of occasions, FERC was provided with sufficient information to raise suspicions of improper activities – or had itself identified potential problems – in areas where it had regulatory responsibilities over Enron, but failed to understand the significance of the information or its implications. Over and over again, FERC displayed a striking lack of thoroughness and determination with respect to key aspects of Enron's activities – an approach seemingly embedded in its regulatory philosophy, regulations, and practices. In short, the record demonstrates a shocking absence of regulatory vigilance on FERC's part and a failure to structure the agency to meet the demands of the new, market-based system that the agency itself has championed. In the end, this investigation reveals that FERC did not fulfill its

role to protect the consumer against abuses that can result if a market-based system is not adequately patrolled by those charged with doing so.

This memorandum will discuss four specific areas in which FERC failed to conduct effective oversight of Enron's activities. The first involves certain wind farms owned by Enron. In an effort to preserve these wind farms' eligibility as so-called "qualifying facilities" eligible for certain economic and regulatory benefits, Enron purported to transfer 50% ownership interests in these wind farms to third parties. At least some of the transactions, however, appear to have been sham sales. Enron, as required under FERC regulations, provided written notice to FERC of each of these sales (as well as subsequent repurchases), along with certain telling details; in some instances Enron in fact sought FERC's affirmative approval of the transactions. Nonetheless, FERC failed to make any effective inquiry – or in some cases, any inquiry at all – into these transactions, enabling Enron to receive substantial benefits for its wind farms to which it may not have been entitled.

Second, the memo will look at an investigation that FERC staff conducted in May 2001 into the operations of Enron Online, Enron's electronic trading platform used to buy and sell electricity and natural gas. The inquiry included questions about the competitive advantage that this trading operation gave Enron traders and whether that advantage could lead to abusive practices in the market; in connection with this inquiry, FERC staff also looked at questions concerning Enron's financial viability. FERC staff asked some of the right questions about Enron's electronic trading activities and finances, but ultimately settled for incomplete, unconvincing, or incorrect answers to those questions. Equally troubling, FERC failed to follow up on some of the most serious concerns raised in the course of its inquiry – concerns that have since been borne out. A critical legal memorandum regarding the basic question of whether FERC had jurisdiction over such trading platforms as Enron Online – which were expected to become the dominant way to trade both electricity and natural gas – was started but left to languish until Chairman Lieberman raised questions about it in a May 15, 2002 letter to FERC Chairman Wood. All this occurred at a time when Enron internal documents uncovered during the Committee's investigation show that the company placed a high priority on maintaining the unregulated status of Enron Online.

Third, the memo will examine questionable transactions between Enron and its FERC-regulated affiliated companies. In particular, shortly before Enron declared bankruptcy, it borrowed approximately \$1 billion through two of its pipeline subsidiaries, securing the loans with the pipelines' assets. When Enron went bankrupt, the pipeline companies – and potentially their ratepayers – were left to repay the loans. In addition, there is evidence suggesting that Enron may have used its public utility affiliate, Portland General Electric (PGE), to engage in the questionable export and reimportation of electricity from California during the Western energy crisis of 2000-2001 and disguised these prohibited interaffiliate transactions. Although FERC has now opened investigations into both matters, before Enron's collapse it had been unprepared and unwilling to act against suspect interaffiliate transactions either because the Commission's rules were inadequate or because it was not able to effectively monitor whether companies were complying with the rules.

The fourth area involves the abusive trading practices that, according to recently released documents, Enron traders engaged in during the California energy crisis. FERC waited nearly two years after the first allegations of market abuse by individual companies arose before launching a formal inquiry into the potentially abusive actions of individual companies. This was despite the fact that FERC was provided with information raising concerns about the exercise of market power in California as early as 1998. Not until February 2002 did FERC pursue evidence that suggested that companies like Enron were manipulating the market. This failure to look at the behavior of individual companies came while Enron, deeply concerned about the effect the Western energy crisis could have on the course of deregulation and on its business, engaged in an extensive public relations and lobbying campaign to influence FERC's actions in the California market.

In addition to examining these areas of failed oversight, the memo will look at the efforts the Commission has undertaken recently to more effectively oversee the contemporary energy markets. Committee staff has serious concerns about whether, as currently constructed, such efforts are likely to result in the proactive, aggressive agency that is needed to protect consumers.

* * *

While we do not know with certainty whether the disclosure of any of the individual activities to be highlighted at the hearing would have prevented Enron's collapse, it seems highly likely that more vigilant, aggressive action by FERC would have limited some of the abuses that appear to have occurred, raised larger questions about Enron's trading practices and other business activities, and unearthed at least some of the cracks in Enron's foundation earlier. Perhaps scrutiny by a federal agency would have jolted the Enron Board of Directors and Enron itself into acting to change direction. At a minimum, we believe it would have alerted investors, analysts, and hopefully other regulators to look more closely at Enron.

I. FERC: BACKGROUND

FERC is an independent, five-member regulatory commission within the Department of Energy. It was created in 1977 as a successor to the Federal Power Commission, which had been established in 1935 by the Federal Power Act. FERC regulates the interstate transmission and wholesale sale of electricity and natural gas, while state and local governments regulate retail sales and intrastate transmission. FERC also licenses hydroelectric projects and regulates the transmission of oil by interstate pipelines.

Over the past 25 years, FERC has overseen a fundamental change in the energy industry from a set of highly regulated monopolies to a system increasingly based on market competition. The regulatory framework as it has evolved and is administered by FERC in three areas that constituted a substantial portion of Enron's energy business – electricity, natural gas, and oil – is, very briefly, as follows:

A. Electricity

The federal regulatory scheme for electric utilities is set forth in the Public Utility Holding Company Act¹ (PUHCA) and the Federal Power Act² (FPA). Both laws were passed in the mid-1930's in response to corporate abuse by utility holding companies. Holding companies were taking advantage of the fact that they owned utilities in multiple states to engage in interstate, intra-company transactions that could not be controlled by state public utility commissions. The Securities and Exchange Commission (SEC) was given authority to regulate matters relating to utilities' corporate structures under PUHCA, including the ability to restrict ownership of multiple utility companies by a single holding company.³ Under the FPA, FERC's predecessor agency – the Federal Power Commission – was given the authority to regulate the rates that could be charged for electricity sold by one utility to another. The FPA required that these wholesale electric rates be “just and reasonable” and nondiscriminatory; rates that are not just and reasonable or are discriminatory are unlawful.⁴ This statutory standard remains in place today. State utility commissions continue to regulate retail rates charged to consumers within their states.

The electricity industry in the U.S. has historically been characterized by vertically integrated utility companies that owned and controlled generation, transmission and distribution systems necessary to serve their own customers. These systems were primarily regulated by state commissions which approved construction of the facilities necessary to provide electric service and consumer rates to recover the cost of those facilities. Generally, sales of power between utilities were overseen by FERC. The situation began to change with the passage of the Public Utility Regulatory Policy Act⁵ (PURPA) in 1979 and the Energy Policy Act⁶ (EPAct) in 1992. PURPA created a new category of independent generation facilities known as “qualifying facilities” or “QFs,” which were allowed to sell electricity to electric utility companies. (QFs include cogeneration facilities (*i.e.*, facilities that simultaneously produce two forms of useful energy, such as electric power and steam) and small power production facilities that use biomass, waste, or renewable resources, including wind, solar and water, to produce electric power). In an effort to develop this new, independent generation industry, utility companies were required to purchase electricity from these QFs at preferential rates in lieu of using their own generation

¹ 15 U.S.C. § 79 *et seq.*

² 16 U.S.C. § 791a *et seq.*

³ *See* 15 U.S.C. § 79k(b)(1).

⁴ 16 U.S.C. §§ 824d(a) and (b); *see also* 16 U.S.C. § 813.

⁵ 16 U.S.C. § 2601.

⁶ 42 U.S.C. § 13201.

capacity. PURPA also required that a QF be owned by an entity that was not already a utility company.

EPAct expanded the universe of “independent” power generation facilities by authorizing utility companies to own independent power generation facilities – that is, power generation facilities that were not captive to a particular utility but could sell to multiple buyers – but without the preferential rates available to QFs; such independent generation facilities are referred to as “exempt wholesale generators” (EWGs). EPAct also required utilities to open up their interstate transmission systems to accommodate wholesale sales of power by competing producers. FERC has the responsibility to oversee these sales of electricity between utilities. FERC also reinterpreted the FPA’s requirement that wholesale electric rates be “just and reasonable” to allow market-based prices to be considered just and reasonable rates.

These changes, along with the decisions by individual states such as California to reorganize their state electric markets along a similar model, resulted in a major shift in the way electricity was generated, transmitted and sold. Rather than electricity being seen as a service provided by regulated monopolies at regulated prices, it became a commodity to be produced and sold at prices set by the market. This in turn created opportunities for energy companies like Enron to enter into the market to buy and sell electricity and even to provide retail service to customers.

B. Natural Gas

The evolution of the natural gas market had similar attributes to that of the electric market. In this case, natural gas pipelines previously served in the role of the “integrated” utility; they purchased gas from producers, transported it, and resold it to local natural gas distribution utility companies. Here too, FERC through its authority under the Natural Gas Act to regulate interstate pipelines,⁷ has moved to require pipelines to “unbundle” these services and allow others to ship natural gas on their pipelines. In other words, FERC has essentially required interstate pipelines to serve as interstate “common carriers” providing transportation to others who purchase or sell natural gas directly.⁸ As in the case of electricity, this has provided opportunities for energy trading companies like Enron to buy and sell natural gas that were not previously available. FERC continued to approve both the rates and construction of pipelines, including those owned by Enron.

C. Oil Pipelines

FERC regulates interstate oil pipelines, which Enron also owned, under the Interstate Commerce Act, through which it has also begun to extend market-based rate authority.

⁷ 15 U.S.C. § 717.

⁸ 15 U.S.C. § 717(c).

In all three areas – electricity, natural gas, and oil – FERC has been instrumental in transforming the way energy products and services are bought and sold from one that relied upon cost-of-service based rates established by FERC, to market-based rates where prices are determined by a competitive marketplace.⁹ Enron was at the forefront of these changes, both arguing for their implementation and structuring its businesses and business strategy to take advantage of them. In the process, Enron became the largest U.S. trader of electricity and natural gas – and one of the most significant companies within FERC’s jurisdiction.

II. FERC’S OVERSIGHT OF ENRON

Although FERC does not directly regulate Enron Corp. (essentially a holding company for the company’s many and diverse operating subsidiaries) as a corporation, *per se*, the Commission has jurisdiction over many of Enron’s energy marketing, generation, and transmission subsidiaries and activities. In response to the Committee’s request, FERC identified 24 electricity marketers, generators or transmitters, 15 gas pipelines, and 5 oil pipelines that are Enron subsidiaries or affiliates and that either are so-called “jurisdictional entities” under the FPA, Natural Gas Act or Interstate Commerce Act or are QFs that must be certified by FERC under PURPA. In addition, Enron appears to have several other electric affiliates that are subject to FERC’s jurisdiction or certification requirements.¹⁰

Not surprisingly, therefore, FERC had thousands of contacts with Enron concerning Enron’s FERC-regulated subsidiaries and affiliates over the ten-year period examined by Committee staff. The vast majority of these involved routine matters such as rate filings, reporting requirements, and system operation. In addition, Enron was very aggressive about using, and seeking to use, the regulatory process to further its own strategic business goals and to protect its economic interests in matters within FERC’s purview; these matters ranged from the promotion of the deregulation of the electric and natural gas markets to FERC’s response to the California energy crisis.¹¹ Enron intervened in dozens, if not hundreds, of proceedings before the

⁹ Cost-of-service based rates are rates that are based on how much it costs for the utility company or pipeline to provide the service. It is calculated by analyzing the costs of building generation equipment, transmission facilities, personnel, financing, and other costs. In contrast, market-based rates are the price that the seller can get for the product in the marketplace. As part of the transition from one rate system to another, FERC has both directly and indirectly required the establishment of a variety of market mechanisms – from auctions by pipelines for available capacity to centralized trading exchanges.

¹⁰ In the course of its investigation, Committee staff came across a number of Enron-affiliated entities, primarily QFs and EWGs, beyond those identified by FERC, that either had filed certifications with FERC or were discussed in internal Enron documents.

¹¹ Enron Corp., “Enron Federal Government Affairs - Outlook & Goals for 1999” (Enron (continued...))

Commission to this end.¹² Enron, moreover, was an active member of a number of industry organizations and coalitions and the company's employees often met with FERC commissioners and staff either as participants in association events or as representatives of the associations themselves.

Among the many Enron matters that came before FERC, or were subject to FERC oversight in recent years, four stood out as examples of significant regulatory failure. In each case, the Enron practices left unpursued by FERC likely contributed, directly or indirectly, to the company's collapse, distorted the appearance of its financial condition, and/or inflicted harm on energy consumers and the energy industry. The Committee staff's findings with respect to each of these matters is set forth in detail below.

A. Enron Wind Farm Transactions

In January 1997, Enron purchased Zond Wind Energy Corporation, a manufacturer and developer of wind energy generation equipment and projects. As a result, Enron became the majority owner of a number of wind farm projects that were considered "qualifying facilities" (QFs) under PURPA and so were eligible for preferential rate treatment.

Shortly thereafter, in August 1997, Enron completed its acquisition of a public utility company located in Oregon – Portland General Electric (PGE). Under PURPA, however, QFs cannot be owned by a public utility or its holding company. Thus, because Enron now owned a public utility company, the wind farm projects it had purchased would no longer be eligible for QF status. In order to maintain the QF status of the wind farms, Enron found it necessary to divest itself of ownership interests in a number of these projects. In a number of cases, however,

¹¹(...continued)
document nos. EC-W 000000228-000000234); Enron Corp., "Overview of Key Energy Policy Issues" (Enron document nos. EC-W 000001131-000001139).

¹² Enron also appears to have sought more broadly to influence policy matters within the Commission's jurisdiction. Enron's Government Affairs office had at least eight people dedicated to working on FERC matters. *See* Enron Corp., "Government Affairs Directory," (Enron document no. EC-W 000003398-000003406), at 6. This was, of course, part of a much reported on, broader effort on the part of Enron to shape its regulatory environment at both the state and federal level: Enron's internal government affairs department documents indicate that the company budgeted \$37.2 million for government affairs activities in 1999, \$33.6 million in 2000 and \$32.5 million in 2001. *See* Enron Corp., "Government Affairs," November 2001 (Enron document nos. EC 000124004-000124010) at 7. It is unknown what portion of these funds were spent on FERC-related activities. Given the company's extensive interactions with FERC, it may well have been a substantial amount. Enron internal government affairs department documents, for example, indicate that Enron was spending \$2 million per year just to promote the creation of Regional Transmission Organizations. *See id.* at 5.

Enron seems to have only appeared to divest itself of ownership, while in fact effectively retaining the risks and benefits of ownership. Enron subsequently repurchased its interest in some of these wind farms in 2000, relying on legal arguments that it was otherwise exempt from the usual ownership requirements to retain the wind farms' QF status.

With respect to both the sales and repurchases of its ownership interests in the wind farms, Enron, as was required, filed documents with FERC informing it of the transactions. FERC, however, failed to give adequate – or, in some cases, any – scrutiny to these submissions.¹³

1. Regulatory Requirements

There are a number of technical and ownership requirements that a facility must meet in order to qualify as a QF. Most relevant here, PURPA requires that a QF be owned by an entity that is not primarily engaged in the sale or generation of electric power.¹⁴ FERC has interpreted this requirement to mean that an applicant must demonstrate that “no more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company.”¹⁵ To determine ownership, FERC looks to two factors: the exercise of control and the stream of benefits accruing to each participant. That is to say, a public utility or utility holding company may not have more than 50% control over the facility and may not receive more than 50% of the stream of benefits – typically defined by FERC as profits, losses and surplus after return of initial capital contribution.¹⁶

FERC regulations provide two alternative means by which the owner of an eligible facility may obtain QF status for that facility. First, the owner may file a formal application with FERC requesting Commission certification of the facility's QF status, which the Commission may grant or deny.¹⁷ Or, at the owner's option, it may file a “self-certification,” attesting that the

¹³ Although FERC reviewed and approved the Enron/PGE merger that triggered the QF ownership requirement, FERC did not consider or attach any conditions to its approval to ensure that the QF ownership requirement was met.

¹⁴ 16 U.S.C. § 796(17).

¹⁵ 18 C.F.R. § 292.206(b).

¹⁶ See *CMS Midland, Inc.*, 38 FERC 61,244 (1987); *Ultrapower 3*, 27 F.E.R.C. 61,094 (1984). This analysis applies where the facility is held by a partnership, as was the case with most of Enron's wind farms discussed herein; where there is direct corporate ownership, FERC is able to measure equity ownership more directly – by whether a utility owns more than 50% of the project's stock.

¹⁷ 18 C.F.R. § 292.207(b).

facility meets the requirements for a QF.¹⁸ Whenever there are changes in material facts about the facility, including changes in ownership, the owner must recertify the facility, again either by formal application to the Commission or by “self-recertification.”¹⁹

When formal certification or recertification of QF status is sought, FERC publishes a notice of the application in the Federal Register and allows interested parties to move to intervene before ruling on the application.²⁰ When a facility owner files a self-certification or self-recertification, no notice is published, although a copy of the self-certification notice must be served on the utilities to which the QF expects to sell electricity and on state regulatory authorities.²¹ As a matter of policy, FERC does not review self-certifications or self-recertifications, unless an affected utility raises an objection to the certification.

In the case of its wind farm sales and repurchases, Enron in some cases requested formal recertifications from FERC, while in others, it filed self-recertifications.

2. *RADR Transactions*

a. **Wind Farm Sales**

In or about May 1997, Enron sold a 50% interest in each of three wind farm projects to a special purpose entity named RADR, which had allegedly been set up by Enron Chief Financial Officer Andrew Fastow and his deputy, Michael Kopper. These transactions were among those that underlay the civil and criminal charges recently brought against Fastow and Kopper.²² The Justice Department and SEC have alleged that these transactions were entered into by RADR so as to “enable Enron to retain secret control over the . . . wind farms while appearing to maintain eligibility for QF status,”²³ and that it was understood that Enron would repurchase its interests in the wind farms from RADR at some point in the future.

¹⁸ 18 C.F.R. § 292.207(a).

¹⁹ 18 C.F.R. § 292.207(d).

²⁰ 18 C.F.R. § 292.207(b)(4).

²¹ 18 C.F.R. § 292.207(a)(1).

²² See Complaint, *SEC v. Kopper*, Civ. Action No. H-02-3127 (S.D. Tex. August 21, 2002); Information, *United States v. Kopper*, Cr. No. H-02-0560 (S.D. Tex. August 20, 2002); Complaint, *SEC v. Fastow*, Civ. Action No. H-02-3666 (S.D. Tex. Oct. 2, 2002); Indictment, *United States v. Fastow*, Cr. No. H-02-0665 (S.D. Tex. Oct. 31, 2002).

²³ Information, *United States v. Kopper*, Cr. No. H-02-0560 (S.D. Tex. August 20, 2002) at 3; see also Indictment, *United States v. Fastow*, Cr. No. H-02-0665 (S.D. Tex. Oct. 31, 2002) at 4.

Documents produced by Enron to the Committee and its Permanent Subcommittee on Investigations further suggest that Enron may not have legitimately transferred its interest in these wind farms. Minutes of a May 1997 meeting of the Finance Committee of Enron's Board of Directors, for example, strongly imply that Enron did not consider the transactions to be true sales and fully expected to retain control over the projects. Thus, the minutes indicate that, although the arrangement was expected to satisfy FERC's requirements for transfer of ownership, it was "not a sale for book purposes" and that Enron therefore could continue to recognize revenues from the projects.²⁴ In addition, the minutes describe Enron's right to repurchase the projects, noting that Enron would retain a "call option to repurchase the assets in future and sell in 'non-fire sale' environment" – an indication that Enron, forced to divest its interests in the wind farms quickly because of QF concerns, was using the sales to RADR to temporarily "park" the projects until it could obtain what it hoped would be more lucrative financial returns.²⁵ Financially, the minutes reveal that Enron provided 97% of RADR's initial capital by way of a loan from one of its subsidiaries and that Enron intended to indemnify RADR against future tax, environmental and other liabilities.²⁶

The nature of these wind farm transactions is further confirmed by a 2001 report by PriceWaterhouseCoopers on its "due diligence" review for the Fastow-controlled partnership LJM when LJM was contemplating purchasing Enron's entire renewable energy subsidiary. The report, consistent with the Finance Committee minutes, notes that, because Enron "retained all the risks and rewards associated with the projects and retained an option to repurchase the shares," the transaction was not treated as a sale and revenue from the projects was accounted for as income from joint ventures.²⁷ The due diligence report further reveals that Enron also guaranteed RADR a minimum return on its investment.²⁸

FERC reviewed and accepted each of these transfers of ownership. With respect to each of the three wind farm projects in which RADR was purportedly acquiring an interest, Enron, through a subsidiary, filed with FERC a formal application for recertification of QF status.²⁹

²⁴ Enron Finance Committee Meeting, May 5, 1997 (Enron document nos. EC 000025710 - 000025733) at document no. EC 000025730 ("Conclusions").

²⁵ *Id.*

²⁶ *Id.*, at Enron document nos. EC 000025727 - 000025729.

²⁷ PriceWaterhouseCoopers, *Project Storm: Draft Report*, July 6, 2001 (Enron Document No. LJM 022403) at 100, 131.

²⁸ *Id.* at 131.

²⁹ Request for Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Windsystems Holding Company*, FERC Docket No. QF87-365-003 (filed May 14, (continued...))

FERC staff reviewed each of these applications, and on June 30, 1997, FERC issued orders finding that the new ownership structure met the Commission's requirements and granting the applications.³⁰ Regardless of whether FERC can have been expected to have uncovered the full extent of the fraud arising out of these transactions, the applications submitted by Enron provided sufficient information to have raised serious questions as to the legitimacy of the sales, and FERC should have at least been alerted to the possibility that its own requirements for QF status had not been met.

The applications do not disclose that Enron executives controlled RADR, but they do reveal that Enron (through a subsidiary) will loan RADR all the money to purchase its interest in the wind farm projects; that an Enron affiliate will indemnify the owners of RADR for certain tax liabilities; that Enron (again, through a subsidiary) has an option to repurchase RADR's interest in the projects; that the land for the facilities will be leased from an Enron affiliate; and that the same Enron affiliate will receive fees for providing operation and maintenance services to the facilities. Taken together, these facts raise a substantial issue about whether ownership has truly been transferred and strongly suggest that Enron is likely to retain more than 50% control and receive more than 50% of the stream of benefits arising from the project.

In reviewing these applications, however, FERC does not appear to have understood or even to have tried to understand the financial arrangements – loans, repurchase options, indemnifications, and fees – described to it by Enron. According to FERC staff, QF applications at the staff level are reviewed by engineers or others with technical expertise to determine the QFs compliance with technical requirements, but typically no one with financial expertise reviews the applications for conformity with the ownership requirements. FERC apparently never probed the salient question of who controlled RADR,³¹ for instance, and Committee staff

²⁹(...continued)

1997); Request for Recertification of Qualifying Facility Status for Small Power Production Facility, *Sky River Partnership*, Docket No. QF91-59-003 (filed May 14, 1997); Request for Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Phase IV Partnership*, FERC Docket No. QF-90-43-002 (filed May 14, 1997).

³⁰ *Zond Windsystems Holding Company*, FERC Docket No. QF87-365-003 (Order Granting Application for Recertification as a Qualifying Small Power Production Facility, June 30, 1997); *Sky River Partnership*, Docket No. QF91-59-003 (Order Granting Application for Recertification as a Qualifying Small Power Production Facility, June 30, 1997); *Victory Garden Phase IV Partnership*, FERC Docket No. QF-90-43-002 (Order Granting Application for Recertification as a Qualifying Small Power Production Facility, June 30, 1997). In each of these cases, the determination to grant the application was made by FERC's Director of the Division of Opinions and Corporate Applications, acting under authority delegated from the Commission.

³¹ In its applications to FERC, Enron represents only that the managing partner of RADR
(continued...)

could find no reference suggesting that FERC either knew or cared that Enron was not treating the “sale” of these facilities as a sale on its own books.

Rather, in its orders granting the wind farms QF status, FERC is conclusory in its analysis, largely parroting back Enron’s representations without further scrutiny. Thus, with respect to the additional moneys Enron would receive from the wind farms’ lease payments and from operations, maintenance and consulting fees to Enron affiliates, FERC unquestioningly accepts that because Enron and RADR each formally have 50% control over the facility and the agreements therefore theoretically could not be entered into without RADR’s assent, that these fee agreements should be presumed to have resulted from “arm’s-length” negotiations. Because FERC viewed these transactions as done at arm’s length, moreover, it determined that, in accordance with its ordinary practice, these additional fees, as well as the money Enron will receive from the loan it is providing to RADR, should not be counted as part of Enron’s share of the “stream of benefits” from the facility. At no point did FERC question why, where there is formally equal control, all the benefits would appear to accrue to one party nor did FERC see the extent of these benefits as possible evidence that this was in fact not an arm’s-length transaction. Overall, FERC appears to have been far more concerned with the form, rather than the substance, of these transactions.

Had FERC probed these transactions, it would have been difficult for it to certify that these transactions met the QF ownership test. In fact, the transactions appear to have been sham sales.

b. Wind Farm Repurchases

In 2000-2001, Enron reacquired a majority interest in a number of QF facilities, including the three RADR projects as well as at least two others. In each of these cases, Enron filed a “self-recertification” with FERC informing it of the change in ownership and asserting that that facility – though now majority or entirely owned by a utility holding company – maintained its eligibility for QF status.³²

³¹(...continued)
is owned by three individuals, who are left unidentified.

³² Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Windsystems Holding Co.*, Docket No. QF87-365-004 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Sky River Partnership*, Docket No. QF91-59-004 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Phase IV Partnership*, Docket No. QF90-43-003 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Cabazon Power Partners LLC*, Docket No. QF95-186-004 (filed January 24, 2001); Notice of Self-
(continued...)

Enron based its self-recertification on FERC regulations issued pursuant to PURPA that provide an exception to the utility ownership limitations for QFs for utility holding companies that are exempt “by rule or order” pursuant to section 3(a)(3) or 3(a)(5) of PUHCA.³³ FERC’s practice, moreover, is to treat a company’s “good faith” application to the SEC for an exemption under these sections of PUHCA – unless and until it is denied by the SEC – to be sufficient to qualify for this PURPA exception.³⁴ As Enron had recently filed such an exemption application with the SEC,³⁵ the company asserted that it should be deemed exempt for purposes of the utility ownership limitations.³⁶ In addition, Enron noted that it was in the process of selling PGE, its sole electric utility subsidiary; once the sale was complete, Enron explained, it would no longer be a utility holding company and so no longer subject to the QF ownership restrictions.³⁷

Because Enron proceeded by self-recertifications in these cases and the recertifications were not initially subjected to challenge by an affected utility company, the self-recertifications

³²(...continued)

Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Power Partners I LLC*, Docket No. QF99-92-001 (filed January 24, 2001).

³³ 18 C.F.R. § 292.206(c)(1). These PUHCA sections provide that the SEC may exempt from the requirements of PUHCA a company that is only “incidentally” a public utility holding company and is primarily engaged in other businesses (15 U.S.C. § 79c(a)(3)) or a company that “derives no material part of its income” from companies the principal business of which is that of a public utility company (15 U.S.C. § 79c(a)(5)).

³⁴ See *Doswell Limited Partnership and Diamon Energy, Inc.*, 56 F.E.R.C. 61,170 (1997). FERC based this policy on an analogous provision in PUHCA, which provides that the filing of an application in good faith shall exempt the applicant from any obligation imposed under PUHCA. See 15 U.S.C. § 79c(c).

³⁵ Enron Corp. Form U-1, Application under the Public Utility Company Holding Act, SEC File No. 70-9661 (April 14, 2000).

³⁶ Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Windsystems Holding Co.*, Docket No. QF87-365-004 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Sky River Partnership*, Docket No. QF91-59-004 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Phase IV Partnership*, Docket No. QF90-43-003 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Cabazon Power Partners LLC*, Docket No. QF95-186-004 (filed January 24, 2001); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Power Partners I LLC*, Docket No. QF99-92-001 (filed January 24, 2001).

³⁷ *Id.*

were, per FERC staff's standard practice, left unreviewed.³⁸

FERC's failure to review the self-recertifications was compounded by the SEC's inaction on Enron's application for the PUHCA exemption. At the time it filed the application with the SEC, Enron was already exempt from PUHCA on other grounds. From an SEC standpoint, therefore, the further exemption request was unnecessary. Nonetheless, Enron made clear in its application to the SEC that its purpose in applying for the additional PUHCA exemption was solely to get out from under FERC's QF ownership rules. Enron, moreover, strongly suggested that it had no interest in the SEC's ruling on the exemption application before the sale of PGE was either completed or abandoned.³⁹

The SEC to date has not ruled on Enron's application for the PUHCA exemption, although it recently announced it would hold a hearing on the matter.⁴⁰ Since the application was initially filed, Enron's intended sale of PGE was abandoned and a subsequent proposed sale to another buyer also fell through; thus, Enron still owns PGE. Coupled with FERC's lack of review of the self-certifications, the net result of all this is that Enron's mere application to the SEC has allowed it to continue to avoid FERC's QF utility ownership restrictions.

Throughout the two-and-half years that Enron's exemption application has been pending with the SEC, furthermore, neither FERC nor the SEC has questioned whether that application was, or continues to be, in "good faith," as FERC requires for it to serve as a basis for exemption from ordinary QF ownership requirements. Indeed, each suggests this is the responsibility of the

³⁸ In a meeting with Committee staff, one FERC staff member observed that, with respect to self-certifications, the Commission does nothing other than to "put a number on a piece of paper."

³⁹ See Enron Corp. Form U-1, Application under the Public Utility Company Holding Act, SEC File No. 70-9661 (April 14, 2000); Letter from Joanne C. Rutkowski, LeBoeuf, Lamb, Greene & MacRae to Catherine A. Fisher, Assistant Director, Office of Public Utility Regulation, Division of Investment Management, Securities and Exchange Commission, dated April 13, 2000. In a 2001 presentation to SEC staff, Enron asserted that "the SEC and Enron agreed to delay pursuing a formal order on the Application pending the PGE sale." Enron Corp., "Alternative PUHCA Exemption for QF Relief - SEC Staff Presentation," July 27, 2001. In an interview with Committee staff, SEC staff denied that there was such an agreement, but stated that it was nonetheless their priority to complete the regulatory review of the PGE sale before turning their attention to Enron's exemption application.

⁴⁰ See *Applications of Enron Corp. for Exemptions Under the Public Utility Holding Company Act of 1935*, SEC Administrative Proceeding File No. 3-10909 (Order Scheduling Hearing, October 7, 2002). This announcement was made coincident with the release of the Committee staff's report on the SEC's oversight of Enron.

other.⁴¹ According to their own accounts, at no point did either agency contact the other to discuss the pending application.

Finally, outside prodding has done little to mitigate FERC's disregard for ensuring that its PURPA requirements are met. In March and April 2002, Southern California Edison (SoCalEd) filed motions with the SEC and FERC, respectively, seeking to intervene in the agencies' respective proceedings in these matters.⁴² SoCalEd argued that Enron's substantially changed circumstances following its collapse rendered its application to the SEC for the PUHCA exemption no longer in "good faith" (if it ever had been) and that, as a result, the validity of the QF status of the relevant wind farms had been brought into question. Until the SEC recently announced it was scheduling a hearing in this matter, neither agency had acted on SoCalEd's motions. In fact, not only did FERC not act on this application, FERC responded to SoCalEd by letter informing the company that there was no pending proceeding in which to intervene, but that if SoCalEd wished to have its motion treated as a "petition for declaratory order" and so considered by the Commission, the company would need to submit a \$16,000 filing fee.⁴³ Only after the Committee announced the instant hearing did FERC initiate an investigation into the appropriate status of three of the wind farms.⁴⁴

In sum, the failure of either agency to act vigilantly in these matters – with respect to the wind farms self-recertifications or the related PUHCA exemption application – left a regulatory "black hole" that Enron has been able to exploit. It has enabled Enron to retain QF status for

⁴¹ In conversations with Committee staff, SEC staff asserted that the decision to rely on a good faith application was FERC's and suggested that it was up to FERC to determine if the application met that agency's standards for good faith. FERC staff, for its part, argued that the application was made to the SEC and that an attempt by FERC to determine whether such an application was in good faith before the SEC had a chance to rule on it would be preemptively second guessing its sister agency's decision.

⁴² Motion to Intervene and Opposition of Southern California Edison Company, *Enron Corp.*, SEC File No. 70-09661 (filed March 26, 2002); Motion to Intervene of Southern California Edison Company, *In re Victory Garden Power Partners I, LLC* (FERC Docket No. QF99-92), *ZWHC LLC* (FERC Docket No. QF87-365), *Victory Garden Phase IV Partnership* (FERC Docket No. QF90-43), *Sky River Partnership* (FERC Docket No. QF91-59), and *Cabazon Power Partners LLC* (Docket No. QF95-186) (filed April 3, 2002).

⁴³ Letter from Magalie R. Salas, Secretary, Federal Energy Regulatory Commission, to James B. Woodruff, Esq., Senior Attorney, Southern California Edison Company, dated May 28, 2002.

⁴⁴ *Investigation of Certain Enron-Affiliated QFs*, FERC Docket No. EL03-17-000 (Order Initiating Investigation and Hearing, issued October 24, 2002). FERC's investigation appears only to encompass the RADR wind farms and not the at least two other QFs in which Enron reacquired a majority interest.

projects which may not be eligible for it – and in so doing, permitted Enron to collect higher rates than it may be legitimately entitled to.⁴⁵

3. *Cabazon Transaction*

In addition to the three RADR sales, Enron sought to transfer its ownership interest in another wind farm project, Cabazon, apparently also in order to retain that project's QF eligibility. In contrast to the RADR wind farms, in the case of Cabazon, Enron did not file a formal application for certification of QF status. Instead, on November 30, 1998, Enron (through a subsidiary) submitted a self-recertification to FERC, asserting that it had transferred a 50% ownership interest in the facility to The Nature Conservancy (TNC), a non-profit organization, thereby complying with the utility ownership limitations.⁴⁶ Approximately six weeks later, Enron implicitly represented that it had reacquired this interest. In a self-recertification filed on January 8, 1999, Enron claimed to now own 40% of the project and that the remaining 60% interest was now owned by another outside party.⁴⁷ Just the previous day, Enron had represented in yet another self-recertification for the same project that it and TNC each had a 50% ownership interest.⁴⁸

According to TNC, however, it never acquired an ownership interest in Cabazon.⁴⁹ On

⁴⁵ SoCalEd estimates that from July 1997 to April 2002, the wind farms at issue have been able to collect as much as \$176 million more than if they had not had QF status. E-mail from Susan Kappelman, Southern California Edison Co. to David Berick, Professional Staff, Senate Committee on Governmental Affairs, dated September 6, 2002. Committee staff has not attempted to independently confirm this number nor have we been able to quantify other financial benefits, such as tax credits and depreciation, that Enron may have received from its ownership interests in these projects.

⁴⁶ Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Cabazon Development Corporation*, FERC Docket No. QF95-186-001 (filed November 30, 1998). It is not clear why Enron waited until a year after Enron acquired PGE and thus became a utility holding company to make such a certification of ownership.

⁴⁷ Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Cabazon Development Corporation*, FERC Docket No. QF95-186-003 (filed January 8, 1999).

⁴⁸ Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Cabazon Development Corporation*, FERC Docket No. QF95-186-002 (filed January 7, 1999).

⁴⁹ E-mail from Karen Berky, Director, Government Relations, The Nature Conservancy, to David Berick, Professional Staff, Senate Committee on Governmental Affairs, dated
(continued...)

November 18, 1998, Enron did assign TNC the rights to receive 50% of the net profits from the Cabazon project.⁵⁰ There is no indication, however, that Enron transferred any ownership interest in, or any right of control over, the facility to TNC,⁵¹ and according to TNC representatives, TNC did not understand this assignment to be the transfer of an ownership stake in Cabazon. Under FERC interpretation, the right to 50% of the stream of benefits from a facility, without more, is insufficient to establish ownership for QF eligibility purposes.⁵² Effective January 8, 1999, Enron terminated the assignment agreement.⁵³

The fact that Enron's filings indicated that it was engaging in a series of ownership changes with respect to the Cabazon QF, including an apparent year-end, short-term assignment of ownership rights to a tax-exempt organization, should clearly have raised concerns with FERC, had FERC staff so much as examined the self-recertifications. Consistent with its policy and practice, FERC, however, did not examine the self-recertifications, nor did it provide public notice that the recertifications had even been filed. Consequently, it did not ask Enron for the supporting details of the ownership arrangement (only an assertion of the ownership allocation was made in the filings, with none of the underlying details reported or relevant documents provided), nor did it contact TNC about the recertification. The result was that FERC missed another opportunity to identify possible wrongdoing by Enron and to ensure that only legitimate QFs were receiving the benefits of that designation.

⁴⁹(...continued)
September 30, 2002.

⁵⁰ Assignment Agreement between Zond Cabazon Development Corporation and The Nature Conservancy, dated November 18, 1998 (Enron document nos. EVE 1788500.0002 - 1788500.00006).

⁵¹ Indeed, the Assignment Agreement specifically provides that “[n]otwithstanding any other provision of this Assignment, Assignee [TNC] is not a partner, joint venturer, alter ego, manager, controlling person or other business associate or co-participant of any kind or nature whatsoever of Assignor [Zond Cabazon Development Corp., an Enron subsidiary] and Assignee does not intend to assume such status.” *Id.* at 5.

⁵² *See Coso Energy Developers et al.*, 85 F.E.R.C. 61,355 (Order Denying Applications for Recertification as Qualifying Facilities, December 16, 1998)

⁵³ Letter from John A. Lamb, Cabazon Power Partners LLC to Laurel Mayer, Esq., The Nature Conservancy, dated January 11, 1999, (Enron document no. EVE 1788500.0001).

B. Enron Online

In October 1999, Enron launched an internet-based electronic trading platform, Enron Online, to trade natural gas and electric power and, later, other commodities. Online energy trading quickly became a significant portion of the energy trading market: in 2001, it was estimated to account for approximately 38% of natural gas and 17% of electric power marketed in the U.S.; at the time, these figures were projected to grow to 72% for natural gas and 45% for electric power by 2005.⁵⁴ Until Enron's bankruptcy, Enron Online was widely acknowledged to be the leading platform for such trading.

Despite these developments in online trading, FERC appears initially to have been largely indifferent to their significance. It was not until May 2001 that FERC's General Counsel initiated a staff-level inquiry into the status of electronic trading in the electric power and natural gas markets, in general, and the role played by Enron Online, in particular. FERC staff were asked to evaluate Enron Online's dominant position in electronic trading in the energy industries and to determine its impact on natural gas and electric markets. A report discussing these matters was completed on August 16, 2001.⁵⁵

The report found that, unlike some online trading platforms which operate as third-party, "many-to-many" exchanges matching willing buyers and sellers, Enron Online operated as a proprietary extension of Enron's trading units, including entities regulated by FERC. In other words, in this so-called "one-to-many" exchange, an Enron trader was a party, either as a buyer or seller, to every trade on Enron Online. Therefore, only Enron would know valuable information about the actual volumes and prices transacted on its trading platform – and, of course, how the prices charged in any particular transaction were set or how they compared to those charged in other, similar transactions.

The report also observed that Enron Online simply served as a trading platform for other

⁵⁴ Memorandum from Marvin Rosenberg and Perry L. Brown, Economists, Office of Markets, Tariffs and Rates; Kim G. Bruno, Attorney, Office of General Counsel; and Mary C. Lauerman, Auditor, Office of the Executive Director to Kevin P. Madden, General Counsel; Daniel L. Larcamp, Director, Office of Markets, Tariffs and Rates; Donald J. Gelinis, Associate Director, Office of Markets, Tariffs and Rates; and John M. Delaware, Deputy Director, Office of the Executive Director, Re: Inquiry into EnronOnline, August 16, 2001 (hereinafter "Enron Online Report") at 9 (citing Forrester Research, Inc., "Net Energy Hits Hypergrowth" April 2001).

⁵⁵ Enron Online Report, note 54, above. On May 14, 2002, Chairman Lieberman wrote to FERC Chairman Pat Wood to express concern about a number of issues raised by this FERC staff report. Chairman Wood responded with a letter to Chairman Lieberman on May 28, 2002. The instant memo reviews the problems identified in Chairman Lieberman's May 14 letter, supplemented by additional information that has since become available.

Enron subsidiaries, shouldering no financial risk on its own. In other words, the financial risk of all the trades conducted through Enron Online remained with these other subsidiaries. This meant the solvency of Enron as a whole was important to the viability of Enron Online and to Enron's trading activity.

With that observation in mind, the report asked whether financial problems at Enron would threaten the energy markets. The report answered the question in two ways. First, it concluded that Enron did not have sufficient market share to disrupt the energy market if it failed. According to the report, Enron accounted for 16 percent of gas trading and 13 percent of electric power trading in North America, with the majority of Enron's trading transacted through Enron Online. In the report's view, the energy market could continue functioning smoothly absent Enron's market share. Second, the report concluded that, in any event, the chance of Enron failing financially was remote. The report provided little support for this conclusion.

Finally, the report found that Enron Online gave a competitive advantage to Enron's own trading units by reducing their transaction costs, giving them wider access to the market, and providing them better market intelligence, but concluded that there was no reason for concern.

In short, though the report identified a number of areas that ought to have troubled FERC as the federal government's lead energy regulator, it found no reason for concern and no cause for action. This was a critical mistake.

First, though FERC staff identified the potential risk inherent in (a) a trading model that exposed the corporation to very large financial risks, and (b) the company's dependence on its corporate credit worthiness to maintain its trading capability and to fulfill its trading commitments, FERC staff failed to take the logical next step to thoroughly understand the significance of this finding. Instead, they conducted only a cursory analysis of Enron's financial standing, concluding that Enron was unlikely to fail as a result of overextending credit to its trading customers. This was obviously a mistake; although the scenario imagined in the report did not come to pass, in fact Enron was financially unstable, and within a few months, had collapsed completely.

Second, the analysis that led to the conclusion that Enron's market share was insufficient to negatively impact the market in the event of the company's failure was far too cursory. The report based its conclusion upon limited industry-supplied data that looked only at the national picture. FERC should have based its conclusion on more thorough data from regional markets, where market concentration would likely have been of greater concern. Moreover, although Enron's failure did not result in major short-term disruptions of energy markets, FERC failed to foresee the broader market effect of Enron's collapse. In Enron's wake, the entire energy trading sector has suffered significant financial distress. As Standard & Poor's (S&P) observed in a recent evaluation of the U.S. utility industry, "[t]he general weakening of credit quality in the U.S. power industry began well before the California and Enron Corp. debacles of 2001, but it

has certainly been exacerbated by them.”⁵⁶ In the first six months of 2002, S&P reported “an unprecedented 78 downgrades among holding companies and operating subsidiaries.”⁵⁷

Third, while FERC staff concluded that the Commission need not worry about the competitive advantage that Enron Online provided to Enron traders, there is now evidence that Enron in fact likely exploited this advantage to manipulate prices, particularly in California and the Western markets. Much of this evidence is set out in FERC’s own post-mortem investigation of energy company activities during the Western energy crisis of 2000-2001, an “initial report” issued in August 2002.⁵⁸ One of the key advantages apparently misused by Enron was one identified in the 2001 Enron Online report – the enhanced “market intelligence” available to it through Enron Online, that is, the ability to see the details of the individual trades going on behind the scenes, while competitors were limited to the summary results posted online. For example, FERC staff’s 2002 report on the Western energy markets describes one case where Enron and an unidentified counterparty made 174 trades with each other on Enron Online in a single day for natural gas being delivered into the California market at the height of the energy crisis.⁵⁹ Other users of Enron Online, however, could only see the bid and ask prices for these transactions; they could not see that the same parties were involved in all of these trades. The net effect of these trades – which, the FERC staff report notes, took place at higher prices than trades with other parties – was to increase the price throughout the day. Though FERC staff stopped short of affirmatively concluding that Enron was attempting to use Enron Online to manipulate market data, it found in its 2002 report that the level of trading activity was “difficult to rationalize as normal or standard business practice.”⁶⁰ In short, the 2001 staff inquiry concluded that there was no reason for concern about Enron Online’s competitive advantage; the 2002 initial investigation report reaches the opposite conclusion.

The effect of any such price manipulation was magnified, furthermore, by another characteristic of Enron Online (also identified by FERC staff in its 2001 Enron Online report) – its use as a significant, but unverifiable, source of price discovery for other market participants. That is to say, energy traders throughout the industry routinely relied on Enron Online to find out

⁵⁶ S&P, “Credit Quality for U.S. Utilities Continues Negative Trend in Second Quarter,” July 12, 2002.

⁵⁷ *Id.*

⁵⁸ Staff of the Federal Energy Regulatory Commission, “Initial Report on Company-Specific Separate Proceedings and Generic Reevaluations; Published Natural Gas Price Data; and Enron Trading Strategies. Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices,” Docket No. PA02-2-000, August 2002 (hereinafter, “Initial Report on the Western Energy Markets”)

⁵⁹ *Id.* at 53.

⁶⁰ *Id.* at 54.

current market prices. Indeed, FERC staff, in its 2002 report on the Western energy markets, found that Enron Online had “played [] a significant, even a dominant, source of price discovery for natural gas products” in the California market.⁶¹ Moreover, Enron Online’s reported prices were a significant component of industry price indices published by third parties.⁶² Thus, the effect of any price manipulation by Enron through Enron Online would be compounded as the inflated prices infected these supposedly independent reports as well. Enron Online’s lack of price transparency and the potential therefore for price manipulation were noted in the 2001 Enron Online report; indeed, FERC staff recommended that, if requested, the Commission should not approve a price index based on Enron Online transactions unless more detailed transaction information was made publicly available.⁶³ Despite highlighting these issues, however, FERC took no further action to investigate whether Enron was manipulating prices or otherwise abusing the advantages with which Enron Online provided it.⁶⁴

Fourth, FERC staff failed to follow up on many of the issues raised by the report. Particularly troubling, given the concerns identified in the report related to Enron's financial risk, it appears that there was never any formal process established within FERC for monitoring the financial status of Enron – North America's largest energy trader – not even following the unexpected resignation of Enron CEO Jeffery Skilling on August 14, 2001. This was a key red flag that occurred just days before the final report was transmitted to FERC managers and, along with news reports about some of Enron’s questionable financial practices, helped persuade staff at the SEC to begin that agency's investigation into Enron's financial condition.⁶⁵ Even once the

⁶¹ *Id.* at 51.

⁶² FERC staff’s Initial Report on the Western Energy Markets notes that in response to agency staff requests to National Gas Intelligence (NGI), NGI reported that a number of its sources relied on Enron Online as their primary price discovery mechanism, even by traders who did not transact on Enron Online. *See id.* at 52.

⁶³ Enron Online Report at 15-16.

⁶⁴ The apparent distortion of published price indices by data from Enron does not appear to be an isolated problem. In the past month, three other energy trading companies – Dynegy, American Electric Power, and Williams Cos. – have publicly disclosed that their traders provided inaccurate information to energy industry publications that compile and publish price indices. See Chip Cummins, “Williams Traders Gave False Data,” *Wall Street Journal*, October 28, 2002; “AEP Dismisses Five for Providing Inaccurate Market Data for Indexes,” AEP Press Release, October 9, 2002; “Dynegy Dismisses Six Employees, Will Discipline Seven Others for Violations of Company Policies,” Dynegy Press Release, October 18, 2002; “Williams Discloses Natural Gas Trade Reporting Inaccuracies,” Williams Cos. Press Release, October 25, 2002.

⁶⁵ Report of the Staff of the Senate Committee on Governmental Affairs on “Financial Oversight of Enron: The SEC and Private-Sector Watchdogs,” S. Prt. 107-75 (October 7, 2002) (continued...)

full magnitude of Enron's financial problems began to take shape in mid-October following Enron's restatement of earnings and public confirmation of the SEC's investigation of the company, there appears to have been no formal effort within FERC to monitor the financial condition of the company or assess possible market impacts. FERC even failed to follow the recommendation made in the staff's August 16, 2001 report that the team that prepared it continue to monitor effectively developments at Enron Online and other electronic trading platforms. There was no effort made at the agency to ensure that this recommendation was heeded.

The significance of FERC's failures to pay more attention to Enron's financial condition is underscored by the agency's reaction, late last year, to news of Enron's collapse. When Enron's demise became evident in November 2001, FERC officials were apparently troubled enough about the potential impacts of the collapse on the energy market – the very concern dismissed in their August report – to raise these matters with representatives of the Federal Reserve, the White House National Economic Council, and Enron itself.⁶⁶

Another very troubling facet of the August 2001 report is that it was not distributed to any of FERC's commissioners prior to, or during, Enron's collapse to inform their decision-making, and it is unclear at what point any of the information contained in the report may have been provided to the Commission. Thus, a report that might have served as a warning wound up being little more than a footnote in the story of Enron's collapse. Moreover, at the same time the report was being prepared, the Commission was debating the appropriate methodology to calculate refunds to consumers in California and the Western markets. The methodology adopted relies, in part, on the energy prices reported in certain public indices.⁶⁷ Had the Commission been given the information uncovered by staff, it could have learned the

⁶⁵(...continued)
at 28.

⁶⁶ See Letter from Pat Wood, III, Chairman, FERC to the Honorable Joseph I. Lieberman, Chairman, Committee on Governmental Affairs, dated April 12, 2002 (listing telephone conversations between Rob Gramlich from the Office of the Chairman of FERC to the White House National Economic Council and the Federal Reserve Board of San Francisco); Letter from Pat Wood, III, Chairman, FERC to the Honorable Joseph I. Lieberman, Chairman, Committee on Governmental Affairs, dated March 4, 2002, (response to question 3(a), at 188) (noting that there were multiple communications between FERC and Enron, including a communication between William Scott Miller of FERC's Office of Markets, Tarriffs and Rates and Rick Shapiro of the Enron Corp.).

⁶⁷ *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Service*, 96 F.E.R.C. 61,120, 61,518 (Order Establishing Evidentiary Hearing Procedures, Granting Rehearing in Part, and Denying Rehearing in Part, issued July 25, 2001) (adopting the recommendation to "use daily spot gas prices" based on the average of spot prices as reported by Gas Daily, NGI's Daily Gas Price index and Inside FERC's Gas Market Report, in calculating refunds).

important fact that the prices reported in such indices were potentially unreliable and subject to manipulation.⁶⁸

Finally, in examining new online markets such as Enron Online, FERC initially did not even bother to address a critical but unresolved question – whether the Commission had jurisdiction over such online trading platforms – even though it was generally understood by FERC staff that electronic platforms such as Enron Online were expected to become the dominant way in which both electricity and natural gas were traded. At the time of the Enron Online inquiry, an accompanying legal memorandum analyzing FERC's jurisdiction over online trading, including Enron Online, was to have been prepared. The memorandum, however, was not completed until July 2002; in fact, nothing was done about finishing it until Chairman Lieberman raised questions about it in his May 15, 2002 letter to Chairman Wood. Ultimately, FERC staff concluded that the Commission likely had jurisdiction over one-to-many type trading platforms for physical electric energy.⁶⁹ Without completing its jurisdictional analysis, however, FERC was poorly positioned to take any action with respect to abusive practices by Enron Online.

Completion of this analysis would also have been useful in clarifying the jurisdictional boundaries between FERC and the Commodity Futures Trading Commission (CFTC) regarding energy trading activities and products, including online trading, and to better define the two agencies' respective market monitoring responsibilities in these developing markets. CFTC does not have general regulatory authority over a one-to-many trading platform such as Enron

⁶⁸ This was not the only instance where the Commissioners may not have been given information relevant to the refund proceeding. In July 2001, FERC's Chief Accountant prepared a memorandum describing the findings of a staff audit to determine whether the books and records of power companies selling power in California inappropriately reflected the cost of generating electric power. The memo noted that "our initial work disclosed various preliminary observations about the costs of generating electricity that may be useful to Commission staff involved in the refund negotiations for overcharges by numerous sellers of energy into the State of California." Memorandum from John M. Delaware, Deputy Executive Director and Chief Accountant to Walter C. Ferguson, Chief of Staff, Daniel L. Larcamp, Director, Office of Markets, Tariffs and Rates, and Kevin P. Madden, General Counsel on "Audit of the Component Costs of Generating Electric Power," undated, at 1 (FERC staff informed Committee staff that the memo was prepared on July 20, 2001). The memo was addressed to the Chief of Staff, FERC's General Counsel, and the Director of the Office of Markets, Tariffs and Rates, but was apparently neither formally submitted to the Commission nor relied upon by the Commission in its initial determination on a refund methodology.

⁶⁹ Memorandum from Dennis Lane, Solicitor, Larry Gasteiger, Beth Pacella, and Laura Vallance, through Cynthia Marlette, General Counsel, to the Commission, re: The Commission's Legal Authority to Regulate "One-To-Many" Internet-Based Trading of Energy Products, July 24, 2002.

Online,⁷⁰ but it does have authority to take action against certain fraudulent or manipulative trading practices.⁷¹ Thus, both FERC and CFTC have at least some regulatory responsibility for online energy trading. Yet, until after Enron filed for bankruptcy, there were no meaningful discussions between the two agencies to identify and coordinate their respective roles in overseeing these sorts of trading platforms, apart from some FERC staff visits to CFTC to educate themselves about the regulation of commodity markets in general.

The jurisdictional analysis was also important to clarify FERC's authority in the face of Enron's apparent determination to avoid regulation of Enron Online and exploit the regulatory gap between FERC and CFTC. The company asserted to FERC that its online trading operations were already subject to "federal oversight" by FERC and CFTC, and an internal memo titled "Talking Points addressing Common Misperceptions" suggested the talking point "There is no regulatory gap."⁷² In fact, however, Enron acknowledged only very limited jurisdiction by either agency over its online trading. A November 2001 internal Enron Government Affairs Department document lists as a current activity "Preserve EnronOnline's unregulated status,"⁷³ and a July 2001 internal Enron memo – written contemporaneously with FERC's investigation into Enron Online – speaks of Enron's "strategy to defend regulatory structuring surrounding EOL [Enron Online] and EOL products."⁷⁴ Thus, an earlier assertion of jurisdiction may have made clear to Enron that its electronic trading was in fact subject to FERC oversight.

Enron Online and other electronic trading platforms are precisely the sort of emerging market institutions that one would expect FERC to anticipate, understand, monitor and address as it moved to deregulate energy markets. Even though FERC eventually initiated an inquiry examining such trading platforms – suggesting some level of concern within the agency about their growing influence – and found that, in fact, the use of online trading platforms and their trading volume were expected to grow dramatically, the agency failed to give these mechanisms the scrutiny they deserve. It is particularly troubling that FERC identified so many red flags – about the financial risks inherent in a one-to-many trading model, about the potential for price manipulation in such a system – and yet, underestimating or misunderstanding their significance, did not take action on any of them. And it is indicative of FERC's failure to live up to its

⁷⁰ 7 U.S.C. § 2(h)(1).

⁷¹ 7 U.S.C. §§ 2(h)(2)(B) and 2(h)(2)(C).

⁷² Enron Corp., "Electronic Platforms and Energy Trading, Talking Points addressing Common Misperceptions," undated (Enron document nos. EC 000124057-124065), at 3.

⁷³ Enron Corp., "Enron Government Affairs," November 2001 (Enron document nos. EC 000124004-000124010), at 3.

⁷⁴ Enron Corp., "Update on Federal Government Affairs Energy Crisis Campaign," July 27, 2001 (Enron document no. ECp000060512).

responsibilities that it did not even finish its legal analysis of the scope of its jurisdiction over these new fast-growing electronic markets until prodded by Chairman Lieberman. Had FERC followed up on its observations, continued to closely monitor Enron and asserted its authority over Enron Online, it might have stopped some of Enron's abusive practices, lessened the harm to energy consumers, and prevented the substantial effects on the energy sector as a whole.

C. Affiliate Transactions

Whenever a company conducts transactions among its own affiliates there are inherent issues about the fairness and motivations of such transactions.⁷⁵ Indeed, concerns about self-serving affiliate transactions were part of what led to the original passage of PUHCA and the FPA in the 1930's.⁷⁶ Among Enron's dubious practices, the company on various occasions appears to have improperly used transactions with its affiliates to further its own financial ends. FERC, however, either had no rules or inadequate rules to address these practices, or, where it had put rules into place, no effective means of monitoring whether companies such as Enron were complying with them.

There are a number of ways in which FERC-administered rules and policies attempt to discourage improper interaffiliate transactions. Most basic, there is the requirement that entities within FERC's jurisdiction may charge only "just and reasonable rates." Were a company whose rates are set in whole or part by FERC – like Enron's natural gas pipeline subsidiaries – to imprudently enter into an unfavorable transaction with an affiliate, the company would not, in principle, be able to collect the additional costs associated with that transaction, because rates based on such costs would not be reasonable.⁷⁷ In addition, FERC, pursuant to statute, has issued rules for "Uniform Systems of Accounts" for electric utilities, natural gas companies and oil pipelines that require these companies to maintain detailed accounting records, including information concerning loans and other transfers between jurisdictional entities and their affiliates.⁷⁸ Such records are subject to FERC inspection and review, presumably a deterrent to

⁷⁵ One concern is that where one affiliate in a transaction has captive customers, a one-sided deal between affiliates can saddle those customers with additional financial burdens. Another concern is that one affiliate will treat another with favoritism at the expense of other companies or in ways detrimental to the market as a whole.

⁷⁶ *See, e.g.*, 15 U.S.C. § 79a(b)(2) (setting forth the legislative basis for PUHCA, including that investors and consumers may be adversely affected "when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition").

⁷⁷ *See Violet v. FERC*, 800 F.2d 280, 282 (1st Cir. 1986).

⁷⁸ 18 C.F.R. Parts 101 (electric utilities), 201 (natural gas companies), and 352 (oil
(continued...))

improper interaffiliate financial transactions.⁷⁹ Most specifically directed at the potential problems of interaffiliate transactions are FERC's "standards of conduct" that apply to companies engaged in interstate electricity or natural gas transmission. The standards of conduct are designed to prevent electric utility companies or gas pipelines, which often exercise monopoly or near-monopoly control over transmission in a given geographic area, from offering to sell and transmit electricity and natural gas to or for their affiliates except to the same extent and under the same terms that the deals are offered to others. Among other things, the standards of conduct require generally that employees involved in the transmission of electricity or natural gas must function independently of those engaged in the wholesale trading of these commodities.⁸⁰

All in all, however, such measures are relatively modest and apparently proved completely inadequate to deter Enron, as the company now appears to have engaged in a number of inappropriate interaffiliate transactions. Perhaps most notable of these interaffiliate transactions are loans that two of Enron's natural gas pipeline subsidiaries obtained for their parent company last November. Specifically, on November 1, 2001, as Enron struggled to avoid bankruptcy, the company announced that JP Morgan Chase & Co. and Citigroup Inc. had committed to loan it a total of \$1 billion.⁸¹ The loans were actually made to two of Enron's

⁷⁸(...continued)

pipelines). The relevant statutes require these companies to keep financial accounts, records and memoranda such as may be prescribed by the Commission as necessary or appropriate. 16 U.S.C. § 825(a) (Federal Power Act); 15 U.S.C. 717(g) (Natural Gas Act); 49 App. U.S.C. 20 (Interstate Commerce Act).

⁷⁹ 16 U.S.C. § 825(a); 15 U.S.C. 717(g); 49 App. U.S.C. 20.

⁸⁰ 18 C.F.R. Part 37 (standards of conduct for electric utilities); 18 C.F.R. Part 161 (standards of conduct for natural gas companies). The Commission has recently proposed a single, new set of standards of conduct that would apply to both natural gas pipelines and electric utilities and would broaden the affiliate relationships covered by the standards. Standards of Conduct for Transmission Providers, 66 Fed. Reg. 50919 (Notice of Proposed Rulemaking, October 5, 2001). Though not a codified requirement, individual companies typically also have "codes of conduct" that govern the relationship between the company's power marketing arm and its traditional public utility affiliates. *See, e.g., Heartland Energy Services, Inc.*, 68 F.E.R.C. 61,223, 62,064-65 (1994) (describing the actions the company, as a condition of it being granted the authority to charge market-based rates, has agreed to take in order to prevent "affiliate abuse").

⁸¹ "Enron Secures Commitments for Additional \$1 Billion in Financing," Enron Corp. Press Release, November 1, 2001. The loans were made through the banks' investment banking arms, JPMorgan and Salomon Smith Barney Inc., respectively. A portion of the loan made by Citigroup was used by Enron to pay off an earlier, unsecured loan from Citigroup, with the
(continued...)

FERC-regulated, interstate pipeline subsidiaries – Northern Natural Gas Company (\$450 million) and Transwestern Pipeline Company (\$550 million) – and were secured by the assets of those pipeline companies. The vast majority of these loan proceeds were subsequently transferred to Enron in the form of unsecured loans from the pipelines to their parent company.⁸² After Enron declared bankruptcy a few weeks later, it made no payments on these loans, and the pipeline companies (which did not file for bankruptcy) were left to pay off the entire amount of the obligations to the banks – a matter of concern because ordinarily such costs would be passed on to shippers who use the pipelines, and ultimately to retail natural gas customers.

In March 2002, FERC began a nonpublic investigation relating, in part, to these transactions and related financial practices,⁸³ and on August 1, 2002, issued an Order to Respond to Northern Natural and Transwestern, directing those companies to “state why they have not violated the Commission’s Uniform System of Accounts for natural gas companies, and why the costs and indebtedness associated with [the November loans] were not imprudently incurred and therefore unrecoverable by the pipelines in any future rate proceedings before [FERC].”⁸⁴ One of the pipeline companies, Northern Natural (which is no longer owned by Enron), has entered into a consent agreement with FERC and agreed not to include the costs associated with the controversial loan in any future rate proceedings,⁸⁵ the other, Transwestern, continues to dispute FERC’s allegations, arguing that the loans were in fact prudent given the facts known at the

⁸¹(...continued)

apparent result that Citigroup was able to replace its unsecured debt with secured debt shortly before Enron’s bankruptcy. *See In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-000 (Order to Respond, issued August 1, 2002) at 3.

⁸² Transwestern and Northern Natural provided the loans to Enron in exchange for promissory notes that stated they were subordinated to prior payment of all senior indebtedness upon the dissolution, liquidation, or reorganization of Enron. *See In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-000 (Order to Respond, issued August 1, 2002). The loans transactions with Transwestern was entered into November 13, 2001; the transaction with Northern Natural was entered into November 19, 2001.

⁸³ Specifically, the investigation was regarding “financial data related to transactions, activities and accounting practices that may have impaired the financial condition of entities subject to the Commission’s jurisdiction for the benefit of corporate parents or other affiliates or associated entities of jurisdictional companies.” *See In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-00 (Order to Respond, Issued August 1, 2002) at 2.

⁸⁴ *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-00 (Order to Respond, Issued August 1, 2002), at 1.

⁸⁵ *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-00 (Order Approving Stipulation and Consent Agreement, issued August 8, 2002).

time.⁸⁶

In addition to these enormous loans, there is preliminary evidence suggesting that Enron may have engaged in a more extensive practice of exploiting the cash generating powers of its pipeline subsidiaries. Documents prepared by JP Morgan Chase in connection with its consideration of the November pipelines loans note that “for years, cash from the pipelines has been used to support operations at Enron Corp.”⁸⁷ At minimum, accounting practices by Enron’s pipeline subsidiaries leave open questions about the nature of Enron’s interaffiliate transactions. The pipeline companies, as well as certain other Enron subsidiaries regulated by FERC, had “cash management agreements” with Enron, whereby, at the end of each day, all remaining cash at the subsidiaries was transferred to Enron, which held and invested it; the subsidiaries themselves maintained no cash reserves. This cash management practice is not unique to Enron.⁸⁸ Nonetheless, Enron appears to have made more extensive use of it than did other energy companies. Information provided by FERC reveals that the amounts transferred by Enron-owned pipeline companies to Enron in 2000 was substantially greater than the amounts transferred by subsidiaries owned by others in the industry to their parents.⁸⁹ Moreover, the amount transferred by Enron subsidiaries itself grew sharply from 1997 to 2000.⁹⁰

⁸⁶ Response of Transwestern Pipeline Company, *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-00 (filed September 3, 2002).

⁸⁷ JP Morgan Global Syndicated Finance, “Structuring Summary, Project Bluehorseshoe,” September 17, 2002, at 3.

⁸⁸ Such cash management practices can provide benefits, such as ensuring that money from all affiliates are invested rather than sitting idle. They also have risks, however: funds swept into a parent’s account typically become the property of the parent and the subsidiary loses all legal interest in those funds. As became apparent in the case of Enron, this arrangement can be particularly problematic when one of the companies files for bankruptcy. *See Regulation of Cash Management Practices*, 67 Fed. Reg. 51150, 51151 (Notice of Proposed Rulemaking, August 7, 2002).

⁸⁹ According to data made available by FERC to Committee staff, Enron-affiliated gas pipeline companies in 2000 had an average balance in their Accounts 146 – accounts used to record receivables from associated companies – of approximately \$195 million, while non-Enron pipelines had an average Account 146 balance of slightly over \$6 million. “Account 146 (Accounts Receivable from Associated Companies) balances as of year end,” table prepared by FERC staff.

⁹⁰ The average Account 146 balance for Enron-affiliated gas pipelines companies increased from approximately \$44 million in 1997 to approximately \$195 million in 2000. “Account 146 (Accounts Receivable from Associated Companies) balances as of year end,” table prepared by FERC staff.

In investigating the cash management practices of Enron and others in the industry, FERC found that the records kept were often inadequate to enable a clear understanding of the companies' financial practices, including, for example, whether and to what extent the parent companies were paying interest to the subsidiaries on the moneys that had been transferred to the parent.⁹¹ With respect to Enron, FERC has alleged that its pipeline subsidiaries did not even have written agreements with Enron governing their cash management practices.⁹² As a result of its investigation, FERC recently proposed to amend its rules governing the Uniform Systems of Accounts to mandate changes in how cash management agreements are administered and reported. FERC's proposal would also limit the amount of funds that can be swept from a subsidiary subject to FERC's jurisdiction to a parent company; under the proposed rules, subsidiaries would have to maintain at least 30% of their capital in their own accounts.⁹³

In addition to possibly exploiting its pipelines to boost its own financial position, it appears that Enron also used another affiliate, Portland General Electric (PGE), to engage in improper transactions affecting the California power market.

On May 22, 2002, PGE responded to a FERC request that participants in the California and Western markets document whether they had engaged in alleged abusive trading practices.⁹⁴ This request was made as part of the Commission's on-going investigation into Enron's trading practices in the California market. While stating in its response that it "does not believe that it has engaged in the strategy contemplated in the Enron memoranda or by the Commission's request for admission," PGE nonetheless acknowledged that "some transactions conducted by Portland General during 2000-2001 may have resulted in the company purchasing power from the Cal PX [California Power Exchange] and reselling power from its portfolio of supplies at prices higher than those paid to the Cal PX."⁹⁵

⁹¹ Regulation of Cash Management Practices, 67 Fed. Reg. 51150, 511152 (Notice of Proposed Rulemaking, August 7, 2002).

⁹² *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-000 (Order to Respond, issued August 1, 2002) at 4. Transwestern has disputed these allegations. See Response of Transwestern Pipeline Company, *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-000 (filed September 3, 2002) at 23-28.

⁹³ Regulation of Cash Management Practices, 67 Fed. Reg. 51150, 51151 (Notice of Proposed Rulemaking, August 7, 2002).

⁹⁴ Response of Portland General Electric Company to the Commission's May 8, 2002 Data Request and Request for Admissions, *Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, FERC Docket No. PA02-2-000 (filed May 22, 2002).

⁹⁵ *Id.* at 6. For more on Enron's allegedly abusive practices in the California market, see Subsection D, below.

As part of its response to the Commission, PGE also included transcripts of some of its trading transactions, which include discussions of a series of transactions that PGE engaged in at the request of Enron traders in the spring of 2000. The apparent purpose of some of these transactions was to assist Enron in exporting power from California, with the intention of reimporting it back to the state at a higher price. According to a legal analysis done in 1999 at PGE's request, Enron's power marketing arm believed that they had found a "loophole in the design of the new competitive marketplace in California which can be exploited to make a profit. . . ."⁹⁶ These transactions also included so-called "sleeve transactions," where a third-party is used to facilitate transactions between affiliates who are otherwise prohibited from trading by FERC's standards of conduct and the companies' codes of conduct. In one of the transcripts provided by Portland General, a power scheduler for Washington Water Power – which served as a third party in one transaction – explained to his PGE counterpart that he was ". . . sleeving it [the power] just because you can't buy it. They [Enron] can't sell it to you."⁹⁷

The transcripts also suggest that some Portland General personnel may have been uncomfortable with some of these transactions. For instance, one PGE employee responsible for scheduling power transmission, told another employee "I'll sure be glad when we're sold and they can't pull this [expletive] anymore."⁹⁸ Despite the scheduler's stated concern, the transactions she was discussing were processed.

In August 2002, FERC opened formal investigations into questionable transactions in the California energy markets between Enron and PGE and between Enron and others using PGE as a middleman, looking at whether, among other things, the companies violated the Commission's standards of conduct; these investigations are ongoing.⁹⁹

⁹⁶ Memorandum from John Mass, LeBoeuf, Lamb, Greene & MacRae L.L.P., to File, August 2, 1999, at 3; (Attachment II.B.-133 to Response of Portland General Electric Company to the Commission's May 8, 2002 Data Request and Request for Admissions, *Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, FERC Docket No. PA02-2-000 (filed May 22, 2002)).

⁹⁷ Transcript of Portland Scheduling Calls, April 15, 2000, at 2 (Attachment III.B.-87 to Response of Portland General Electric Company to the Commission's May 8, 2002 Data Request and Request for Admissions, *Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, FERC Docket No. PA02-2-000 (filed May 22, 2002)).

⁹⁸ Transcript of Scheduler Telephone Conversation, April 6, 2000, at 29 (Attachment III.B.-46 to Response of Portland General Electric Company to the Commission's May 8, 2002 Data Request and Request for Admissions, *Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, FERC Docket No. PA02-2-000 (filed May 22, 2002)).

⁹⁹ *Portland General Electric Company et al.*, FERC Docket No. EL02-114-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued (continued...))

While it is a positive development that FERC is now investigating potential wrongdoing concerning Enron's interaffiliate transactions and seeking to strengthen some of the relevant accounting rules, at the same time it is troubling that FERC failed to address these issues at an earlier stage. In the case of the pipeline loans, the Commission seems to have been largely blind to the possibility of financial chicanery in interaffiliate transactions. Despite periodic audits of company accounts and records, FERC apparently did not fully appreciate the inadequacy of much of the information being kept or the significance, for example, of large interaffiliate financial transfers, and such practices were not identified as problems warranting Commission action until after Enron's collapse.¹⁰⁰ With respect to Enron's transactions with PGE, FERC already has rules restricting interaffiliate sales of power or power transmission capacity that apparently prohibited these transactions. The Commission, however, has not developed the capacity to monitor whether interaffiliate transactions are in fact taking place or the terms or circumstances of those transactions. Unfortunately, it is not enough to simply set up the market rules; to fulfill its mission FERC must understand what is actually happening in the market. Without doing so, FERC is left to hope, but not to know, that the rules are being followed.

D. California/Western Market Trading and Marketing Abuses

Severe energy problems in California began in the spring of 2000, only two years after the state's energy deregulation plan was put into place. FERC had already received reports from energy experts in California that raised concerns about the exercise of market power as far back as 1998.¹⁰¹ The state's investor-owned utilities placed the blame for the crisis on power sellers and marketers who, they said, were unfairly manipulating the system to score tremendous

⁹⁹(...continued)

August 13, 2002); *Avista Corporation et al.*, FERC Docket No. EL02-115-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002).

¹⁰⁰ FERC staff had performed audits of Transwestern and Northern Natural in 2000 for the years 1997-1998, for the limited purpose of validating the annual charges to be paid by the pipeline companies to the agency (which were based on gas revenues). See Letter from John M. Delaware, Deputy Executive Director and Chief Account, Office of the Executive Director, FERC to Robert Chandler, Director, Accounting and Reporting, Transwestern Pipeline Company, dated October 11, 2000; Letter from John M. Delaware, Deputy Executive Director and Chief Account, Office of the Executive Director, FERC to Robert Chandler, Director, Accounting and Reporting, Northern Natural Gas Company, dated October 11, 2000. In addition, regulated companies must submit certain financial information annually to FERC, including the amount of receivables from associated companies (so-called Account 146 data).

¹⁰¹ Market Surveillance Committee of the California ISO, "Preliminary Report on Operation of the Ancillary Services Markets of the California System Operator (ISO)," August 19, 1998; Market Monitoring Committee of the California Power Exchange, "Report on Market Issues in the California Power Exchange Energy Markets," August 17, 1998.

profits. The power marketers, on the other hand, pointed to flaws in the structure of the new California system.

FERC staff investigated allegations of possible market abuses in the summer and fall of 2000. They concluded that power sellers had the *potential* to manipulate the power market, but the Commission staff stated that there was no evidence to indicate whether any individual company engaged in *actual* market abuse. In its response to the staff report, the Commission agreed with this conclusion, stating: “While this record does not support findings of specific exercises of market power, and while we are not able to reach definite conclusions about the actions of individual sellers, there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the [Federal Power Act].”¹⁰²

The staff report suggested that further investigation was needed before determining whether the power sellers and marketers did, in fact, manipulate the system.¹⁰³ However, it took 15 months – until February 2002, after Enron had collapsed and questions were raised about its business practices – before the Commission would order an investigation into the market behavior of individual companies. Once begun, however, this preliminary investigation would uncover evidence suggesting that some of the types of abuses that had been alleged to take place in California did, in fact, occur.

In August 2002, Commission staff produced an interim investigative report that described the manipulative trading practices that Enron’s traders and others had allegedly engaged in.¹⁰⁴ Based on the findings of this report, the Commission is now conducting three formal investigations to further review allegations that individual companies, including Enron, manipulated the California market.¹⁰⁵ Last month, Timothy Belden – who headed Enron’s Western trading desk – pled guilty to a charge of conspiracy to commit wire fraud based on allegations that, from 1998 to 2001, he and others at Enron engaged in trading strategies

¹⁰² *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 93 F.E.R.C. 61,121, 61,350 (Market Order Proposing Remedies for California Wholesale Electric Markets, issued November 1, 2000).

¹⁰³ “Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities,” FERC, November 1, 2000, at 5-16.

¹⁰⁴ Initial Report on the Western Energy Markets, note 58, above.

¹⁰⁵ *Portland General Electric Company et al.*, FERC Docket No. EL02-114-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002); *Avista Corporation et al.*, FERC Docket No. EL02-115-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002); *El Paso Electric Company et al.*, EL02-113-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002).

designed to manipulate energy prices in the California market.¹⁰⁶

As noted earlier, we cannot say with certainty that an earlier investigation and more aggressive activities by the Commission would have prevented Enron's collapse. However, because of the California power crisis in 2000 and early 2001, FERC specifically examined the operation of those markets and was presented with the opportunity, if not the obligation, to review Enron's trading practices. An earlier examination by the Commission of the type of practices engaged in by Enron could have led to an earlier investor and regulatory review of Enron's vaunted commodity trading business, and then to larger questions about its business activities. This did not occur.

The fact that the Commission is only now investigating allegations of market abuse by individual companies is deeply troubling, particularly for the many consumers who were adversely affected by the California power crisis. Without the threat of timely enforcement by a regulatory agency to hold market participants accountable, rules cannot serve their purpose as a deterrent to abusive market action.

1. Power Crisis in California

In the late 1990s, California became one of the first states to deregulate its electricity industry. As part of its deregulation plan, the State's large investor-owned utilities (IOUs) were required to divest themselves of large portions of their generating capacity.¹⁰⁷ Instead of generating it themselves, the IOUs were required to purchase electricity on several complex wholesale spot markets established by the California Power Exchange (PX) and the California Independent System Operator (ISO). Through these markets, thousands of transactions were conducted each day. Electricity was bought and sold for the "day-ahead" market, for the "same-day" market, and for other electricity supply components, such as extra generating reserves. Once the IOUs purchased the electricity on the wholesale market, they could, in turn, deliver it to their customers through the state-wide electric grid. The California deregulation plan also established the ISO to operate this grid and to ensure that there was an adequate supply of electricity to meet customers' demands. When there was a shortage in the supply of electricity relative to the demand on the California PX, the ISO would purchase additional energy. The price the ISO would pay power sellers and marketers, such as Enron, for this additional energy was capped when the power was purchased from in-state sources; when the ISO purchased from out-of-state sources, however, there was no price cap.

In addition to wholesale price caps, California's deregulation plan also required a freeze

¹⁰⁶ Plea Agreement, *United States v. Belden*, No. CR 02-0313 MJJ (N.D. Cal. October 17, 2002); Information, *United States v. Belden*, No. CR 02-0313 (N.D. Cal. October 9, 2002).

¹⁰⁷ The California IOUs retained their nuclear plants, and some other assets, but were required to sell the electricity produced by these plants into spot markets established by the California Power Exchange (PX).

on retail electricity rates. While this freeze was often described as a “cap” on retail prices, it was originally considered a *minimum* floor price that the IOU could charge its customers. This floor price would allow the IOUs to recover the cost of investments, known as “stranded costs,” that were made during their tenure as regulated monopolies. Retail rate freezes are common in essentially all deregulation plans. In California’s case, the freeze stayed in effect until all of the individual utilities’ stranded costs were recovered or until March 2002, whichever came first. Consequently, when San Diego’s IOU recovered all of its stranded costs in 1999, retail rate “caps” for the area were lifted. Rate caps remained in place for other consumers who were served by IOUs that had not recovered all of their stranded costs.

The energy crisis in California began in the spring of 2000 when a power shortage in the wholesale market increased the price of electricity that IOUs were purchasing on the California PX. The absence of retail rate caps for the San Diego IOU meant that the additional costs on the wholesale market could be transferred directly to its ratepayers. As a result, these ratepayers saw their electric bills increase by 200 to 300 percent. However, consumers served by the other California IOUs were not immediately affected by the wholesale price spikes. Their IOUs had not fully recovered their stranded costs, and as such, were still operating under the retail price caps. Because of these caps, the IOUs were not allowed to transfer their additional costs to consumers. As a result, IOUs began losing large sums of money. One IOU was even forced into bankruptcy.

On June 28, 2000, the California ISO responded to the crisis by lowering the wholesale price caps for power generated within the state and purchased by the ISO on its spot market. The cap was reduced from \$750 per megawatt hour to \$500, and later \$250, in an attempt to lower how much the power sellers and marketers were charging the ISO and, in turn, reduce the rates for consumers.¹⁰⁸

2. *FERC’s Investigation of the California and Western Markets*

As problems arose in 2000, there is a strong argument that the Commission – which had jurisdiction over trades through the California PX and ISO because they involved wholesale sales of electricity – should have shown greater concern based on previous reports it received of possible anti-competitive behavior in the market.¹⁰⁹ Certainly, problems in the California market

¹⁰⁸ According to a presentation made by Southern California Edison to the Director of FERC’s Office of Markets, Tariffs, and Rates (OTMR), the total cost of electricity for California for the month of June 2000 even under the \$750 cap was over \$3.6 billion, roughly half of what the state had spent for electricity for the entire year of 1999. Southern California Edison Company, “Status of California Electricity Markets,” August 3, 2000.

¹⁰⁹ By contrast, the State of California was primarily responsible for overseeing retail power sales. To the extent that the ISO had been delegated authority by FERC to set rate caps
(continued...)

were not a new issue to FERC. For example, in an August 19, 1998 report to the ISO board that was transmitted to FERC the same day, the Market Surveillance Committee for the PX found that the market was not functioning in a competitive manner.¹¹⁰ Even more forcefully, in another report to FERC from the same time period, the Market Monitoring Committee for the PX found that “the current market problems are sufficiently severe that they call for short-term intervention in the markets, such as price caps.”¹¹¹

On July 26, 2000, FERC ordered its staff to investigate the five so-called “bulk power” markets in the U.S. to examine how the electricity markets in different regions were functioning. On August 23, 2000, FERC initiated a second, formal investigation in response to a complaint filed by San Diego Gas & Electric pursuant to Section 206 of the Federal Power Act.¹¹² The FERC Chairman also directed the staff to accelerate the portion of the bulk power investigation relating to the California and Western markets so that it could be used to inform the Commission’s decisions regarding the California market.¹¹³

On November 1, 2000, the FERC staff released its report on the California and Western bulk power market and the causes of the summer 2000 electricity price spikes. The report, and

¹⁰⁹(...continued)

for wholesale power, these caps only applied to in-state generators. It is alleged that Enron took advantage of this situation by exporting power from California with the intention of re-importing it back to the state. See Memorandum from Christian Yoder and Stephen Hall, Stoel Rivers LLP, to Richard Sanders, re: Traders Strategies in the California Wholesale Power Markets/ISO Sanctions, December 6, 2000, at 6-7. By doing so, the company could apparently avoid the price caps that the ISO placed on California-generated power and receive higher payments for electricity that appeared to be generated out-of-state. Only FERC had the authority to regulate power imported from one state to another.

¹¹⁰ Market Surveillance Committee of the California ISO, “Preliminary Report on Operation of the Ancillary Services Markets of the California System Operator (ISO),” August 19, 1998.

¹¹¹ Market Monitoring Committee of the California Power Exchange, “Report on Market Issues in the California Power Exchange Energy Markets,” August 17, 1998.

¹¹² *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 92 F.E.R.C. 61,172 (Order Initiating Hearing Proceedings To Investigate Justness And Reasonableness Of Rate Of Public Utility Sellers In California ISO and PX Markets And To Investigate ISO and PX Tariffs, Contracts, Institutional Structures And Bylaws; And Providing Further Guidance To California Entities, issued August 23, 2000).

¹¹³ “Commission Addresses California Electricity Markets, Orders Investigation,” FERC Press Release, August 23, 2000; see also *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 92 F.E.R.C. at 61,603.

the subsequent changes proposed by the Commission, focused on the structural problems in the California market, rather than on the specific actions of individual companies operating within the market.¹¹⁴

The investigation leading up to the November 1 report was extremely limited in scope and duration – the staff conducting the investigation was not even given subpoena authority, and the investigation was completed in a very short period of time (roughly three months). Although the Commission directed the staff to focus on California and the Western markets in its August 23, 2000 order, there does not in fact appear to have been any significant shift in investigative priorities. Staff reports for all five bulk power regions, including the California/Western report, were issued on the November 1, 2000 date originally established in July. In addition, key market participants, observers and regulators, such as utility commissions in surrounding Western states and the Bonneville Power Administration, were never interviewed even though the report repeatedly acknowledges that the Western market is an interconnected, interdependent market.¹¹⁵

Because of the limited scope of their investigation, FERC staff did not pursue all of the major potential problems that existed in the California market. Most notably, FERC staff failed to fully address allegations of market manipulation by individual power selling companies operating in California. For instance, FERC staff appears not to have given sufficient attention to reports done by a variety of California sources regarding market behavior. On August 10, 2000, for example, the Department of Market Analysis of the California ISO issued a report that examined price spikes that had occurred in May - June 2000. The ISO report found that market participants were exercising market power, stating “the observed market power was the combined effect of the bidding activity of in-state and out-of-state generation resources.”¹¹⁶ An even more detailed analysis of the California market was submitted to the Commission by the ISO on October 20, 2000.¹¹⁷

As they acknowledge in their November 1, 2000 report, FERC staff was aware of such “concerns” about market abuses, including the exporting of power out of California. They noted

¹¹⁴ “Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities,” November 1, 2000.

¹¹⁵ Although the report lists entities with whom interviews were done, many of the listed “interviews” were group meetings with FERC staff and not what Committee staff view as investigative interviews.

¹¹⁶ Department of Market Analysis, California Independent System Operator, “Report on California Energy Market Issues and Performance: May-June, 2000,” August 10, 2000, at 5.

¹¹⁷ Declaration of Eric Hildebrandt, *San Diego Gas & Electric Co. v. All Sellers of Ancillary Services*, F.E.R.C. Docket No. EL00-95-000, attached to Letter from Edward Berlin, Swidler Berlin Shereff Friedman, LLP to the Honorable David B. Boerges, Secretary, FERC, dated October 20, 2000.

that one of these concerns was “that generators exporting power were gaming the system in order to increase prices.”¹¹⁸ Their report goes on to observe that “(t)he concern seems to be that megawatts are exported by the very same entities who then sell the megawatts back in real time at high prices. Several generators reported contracting a significant proportion of their supply forward outside of California, and the buyers of that power may have exported it back to California at some later date.”¹¹⁹

Representatives of California’s investor-owned utilities also met with the co-director of the FERC investigation and other FERC staff on August 17, 2000, to discuss this export issue and other allegations of market abuse. One of the utilities, Southern California Edison, presented a detailed list of alleged trading abuses such as intentional creation of transmission system congestion and megawatt laundering – the export of power out of California and the subsequent re-importation at higher prices.¹²⁰

Despite this evidence of possible market abuse that FERC staff had received, their November 1, 2000 report concluded that there was nothing to indicate whether an individual company engaged in *actual* market abuse. Instead, the staff suggested that power sellers and marketers had merely the *potential* to exercise market power in the summer of 2000. They stated that further investigation was needed to “substantiate any charges of market power abuse,” and presented the Commission with the option of continuing the investigation to examine these alleged market power abuse issues in greater detail.¹²¹

¹¹⁸ “Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities,” FERC, November 1, 2000, at 5-14, 5-15.

¹¹⁹ *Id.* at 5-15.

¹²⁰ Gary Stern, Southern California Edison, “California Electricity Markets: Issues for Examination,” August 17, 2000.

¹²¹ “Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities,” November 1, 2000, at 5-16.

Coincident with the publication of the bulk power investigation reports, the Commission on November 1, 2000 also issued an order finding that “(w)hile this record does not support findings of specific exercises of market power, and while we are not able to reach definite conclusions about the actions of individual sellers, there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight, and can result in unjust and unreasonable rates under the FPA.”¹²² The order went on to propose a variety of mitigation measures aimed at changing the operation of the California spot markets operated by the California PX and the ISO; initial mitigation measures were actually imposed by a further Commission order on December 15, 2000.¹²³ (It should be noted that this initial mitigation order would prove wholly inadequate to address the crisis in California and FERC was forced to put substantially stronger measures in place the following spring.)

While issuing its mitigation proposals, the Commission did nothing to address the problem of individual companies’ abusive practices, including responding to staff’s proposal to continue its investigation, for almost 15 months after receiving the staff bulk power report. This was despite the fact that FERC continued to receive additional evidence that market abuse was occurring. In February 2001, for example, the market oversight unit of the California ISO, responding to reports that FERC had insufficient data on market abuse, submitted a new study of the bidding behavior of 15 individual companies, including Enron. Finally, on February 13, 2002, the Commission ordered FERC staff to begin a preliminary investigation.¹²⁴

With one exception – a single, isolated instance involving standby generation units being withheld from service – the February 13, 2002 order was the first action that FERC took to independently investigate the market behavior of any electricity market participant in the California and Western markets. And it took an additional six months before FERC initiated formal investigations of such participants. Had the Commission agreed to start a more thorough investigation immediately following the release of the November 2000 staff report, it may well have uncovered earlier the type of evidence it believed necessary to substantiate the charges of market abuse in California.

¹²² *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, 93 F.E.R.C. 61,121, 61,350 (Order Proposing Remedies for California Wholesale Electric Markets, issued November 1, 2000).

¹²³ *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, 93 F.E.R.C. 61,294 (Order Directing Remedies for California Wholesale Electric Markets, issued December 15, 2000).

¹²⁴ *Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 98 F.E.R.C. 61,165 (Order Directing Staff Investigation, issued February 13, 2002).

Indeed, on October 3, 2000 – nearly a month before the staff’s bulk power report was issued – Enron itself began its own internal investigation¹²⁵ of the company’s trading practices in the California energy market when outside attorneys and senior Enron legal counsel and staff met in an all-day session with Enron traders in Portland, Oregon.¹²⁶ This meeting included, among others, Timothy Belden, Richard Sanders, who headed litigation for Enron North America, and Mary Hain, a director in Enron’s Government Affairs department, who, as discussed below, had a couple of months earlier given a presentation to FERC staff on issues related to the California market.¹²⁷ A follow-up meeting with senior Enron legal staff (including Sanders) was held on November 4-5, 2000.¹²⁸ Another meeting took place in December 2000.¹²⁹

Enron’s internal investigation ultimately resulted in a December 6, 2000 memorandum that analyzed in detail a range of strategies that Enron traders may have used to exploit the structure of the California market to increase Enron’s profits – the so-called “Get Shorty,” “Death Star,” “Fat Boy,” and “Ricochet” trading strategies – and discussed the “sanction provisions of the California Independent System Operator (‘ISO’) tariff.”¹³⁰ As the head of Enron’s Western trading desk at the time, Timothy Belden was a participant in the internal investigation that produced these memoranda. As noted above, Belden subsequently pled guilty to a charge of conspiracy to commit wire fraud, related to allegations that he engaged in trading

¹²⁵ This internal investigation of its trading practices was initiated by Enron in order to respond to subpoenas and inquiries from the California Public Utility Commission, and to related inquiries and litigation. See Deposition of Christian Good Yoder, *Nevada Power Company et al. vs. Duke Energy Trading and Marketing et al.*, FERC Docket No. EL02-26-000 *et al.*, June 18, 2002, at 20 (hereinafter, “Yoder Deposition”).

¹²⁶ Deposition of Stephen C. Hall, *Nevada Power Company et al. vs. Duke Energy Trading and Marketing et al.*, FERC Docket No. EL02-26-000 *et al.*, July 11, 2002, at 18 (hereinafter, “Hall Deposition”); Yoder Deposition at 27; Invoice from Stoel Rives LLP to Christian Yoder, Enron Capital & Trade Resources Corp, re: Enron North America, California Power Matters, dated November 27, 2000 (itemizing attorney services), available at <http://caag.state.ca.us/newsalerts/2002/02-058.htm>.

¹²⁷ E-mail from Mary Hain to James Steffes, et al, dated August 29, 2000 (Enron document no. ECu000060541); Hall Deposition at 18.

¹²⁸ Yoder Deposition at 48.

¹²⁹ *Id.* at 50.

¹³⁰ Memorandum from Christian Yoder and Stephen Hall, Stoel Rivers LLP, to Richard Sanders, re: Traders Strategies in the California Wholesale Power Markets/ISO Sanctions, December 6, 2000. There is another, nearly identical version of this memorandum that is dated December 8, 2000. Both versions of the memorandum were released to the public by FERC on May 6, 2002.

strategies designed to manipulate prices in the California energy market. In his plea agreement, Belden acknowledged that between 1998 and 2001, he and “other individuals at Enron agreed to devise and implement a series of fraudulent schemes” in the California market that were designed to “obtain increased revenue for Enron from wholesale electricity customers and other market participants”¹³¹

3. *Enron’s Efforts to Influence FERC*

Enron was heavily invested in the success of the deregulation of energy markets in general and in California in particular.¹³² Deregulation represented opportunities for its energy trading and energy services businesses, as well as new market opportunities in the United States and overseas. It was important to Enron, therefore, that the California crisis not be blamed on deregulation or market systems or on the market players in a deregulated environment.

Documents obtained by the Committee indicate that Enron attempted to directly and indirectly influence FERC’s investigation of the California market and subsequent decision-making. As indicated by an internal e-mail obtained by the Committee, and confirmed by the Commission staff, Enron representative Mary Hain made a presentation to the FERC “bulk power” investigation team on August 24, 2000 as part of a meeting that the team held with a group of power marketers.¹³³ The message Enron sought to convey was that high prices in California were the result of scarce supply and that FERC should be “discouraged . . . from taking any action that would hurt the vibrant wholesale market in the [sic] California and the rest

¹³¹ Plea Agreement, *United States v. Belden*, No. CR 02-0313 MJJ (N.D. Cal. October 17, 2002); Information, *United States v. Belden*, No. CR 02-0313 (N.D. Cal. October 9, 2002).

¹³² For example, on January 20, 2000, Enron held its annual equity analyst conference, announcing “(g)rowth prospects remain strong for Wholesale Energy Operations and Services, Enron’s largest business. Wholesale energy growth in North America is expected to be driven by the continuing deregulation of power markets in the United States and large-scale outsourcing utilities and large energy consumers.” A year later, at the January 2001 conference, Enron announced increased earning targets based in part on “Enron’s further strengthening of its long-standing lead in the North American wholesale energy market, significant expansion of its European wholesale energy business, and extension of Enron’s business model into new, large markets” as well as a doubling in its retail energy business. See “Enron Hosts Annual Analyst Conference; Provides Business Overview and Goals for 2000,” Enron Corp. Press Release, January 20, 2000; “Enron Announces Increased Earnings Target for 2001 to \$1.70 - \$1.75 Per Share,” Enron Corp. Press Release, January 25, 2001.

¹³³ E-mail from Mary Hain to James Steffes, *et al.*, dated August 29, 2000 (Enron document no. ECu000060541); Letter from Kevin F. Cadden, Director of External Affairs for FERC, to David Berick, Senate Committee on Governmental Affairs, dated June 19, 2002.

of the West. . . .¹³⁴ According to an internal Enron e-mail, on August 25, 2000, Timothy Belden, then head of Enron’s Western trading desk, had a discussion with FERC investigators and sent them another presentation – “What To Do About Western Wholesale Markets?” – which reiterated this basic message that the price spikes were due to physical supply shortages and structural flaws in the California market.¹³⁵

Even after the Commission issued its initial mitigation order in December 2000, Enron continued to be actively involved in efforts to address the California crisis. For example, Ken Lay met with members of the Clinton Administration in early January 2001 to discuss the crisis. On January 9, 2001, Lay attended a “summit” organized by the White House to talk about possible solutions to the energy crisis in California. The President’s chief economic advisor Gene Sperling, FERC Chairman James Hoecker, Treasury Secretary Lawrence Summers and Secretary of Energy Bill Richardson were among the 30-50 people that attended the summit.¹³⁶ On January 13, 2001, Ken Lay also participated in what appears to be a follow-up meeting to the January 9 summit.¹³⁷

Thereafter, the company launched a major public relations and lobbying campaign in early 2001 apparently designed to indirectly influence the outcome of FERC’s decision-making with regard to California. The Enron campaign consisted of an extensive multi-faceted effort to influence policy decisions not only in California, but throughout the Western U.S., in other key markets such as New York, where it was feared that other potentially damaging electricity shortages and price spikes would occur, and at the federal level.¹³⁸ The campaign was directed by Enron’s corporate head of government affairs with the assistance of the Washington DC-

¹³⁴ E-mail from Mary Hain to James Steffes, *et al.*, dated August 29, 2000, (Enron document no. ECu000060541).

¹³⁵ E-mail from Mary Hain to James Steffes, *et al.*, dated August 29, 2000 (Enron document no. ECu000060541); Tim Belden, Enron North America, Presentation on “What To Do About Western Wholesale Markets?,” August 25, 2000 (Enron document nos. ECu000060613-ECu000060664). FERC staff could not confirm that the discussion had taken place, but acknowledged that they do have a copy of the presentation.

¹³⁶ Letter from James J. Hoecker, Swidler Berlin Shereff Friedman LLP, to Susan J. Cort, Esq., Office of General Counsel, FERC, March 12, 2002, at 3; Carolyn Lochhead, “Progress Toward Deal to Cut Power Cost / D.C. energy talks run late into night,” *San Francisco Chronicle*, January 10, 2001.

¹³⁷ Letter from James J. Hoecker, Swidler Berlin Shereff Friedman LLP, to Susan J. Cort, Esq., Office of General Counsel, FERC, March 12, 2002, at 3.

¹³⁸ Enron Corp., “Advancing Electric Competition in the Wake of California; Enron’s Campaign to Affect Policy and Public Opinion,” February 5, 2001 (Enron document nos. ECp000061965-ECp000062027).

based lobbying firm Quinn, Gillespie and Associates.¹³⁹

A February 5, 2001 briefing on the campaign identified six overall objectives – “Isolate California and communicate a market based message; Retain a market-based electricity structure in California; Minimize California impact and Governor Davis’ message across the West; Facilitate federal action: FERC and Congress; Identify and manage potential energy crisis in other states–New York, Florida, others?; Refine and increase public affairs effort among policy makers, the media, opinion makers, electricity consumers.”¹⁴⁰

As the campaign progressed, the goals and objectives were refined. A May 4, 2001 campaign briefing identified five federal goals relevant to FERC: to encourage FERC and the White House to promote competition in electric markets; to convince FERC to extend its jurisdiction over all aspects of electricity transmission, including over federal, state, and municipal power agencies that are not otherwise subject to FERC jurisdiction; to encourage the Administration to complete confirmation of its FERC nominees; to educate Members of Congress and the Administration about the West Coast energy crisis and encourage them to allow the market to work and to take efforts to increase supply and reduce demand; and to block price cap legislation and administrative orders.¹⁴¹

As reflected in the May 4 briefing, one of Enron’s goals was to complete the confirmation of FERC nominees in hope of creating a more proactive FERC that would address the growing threat that the California crisis presented to deregulation. On January 8, 2001, Enron’s Chairman and Chief Executive Officer Kenneth Lay wrote to Clay Johnson, Executive Director of the Bush-Cheney Transition team, and Vice President-elect Cheney, to offer Enron’s recommendations on “the kind of individuals we think you should be looking for” when filling vacancies at FERC.¹⁴² Attached to the letter was a list of seven potential candidates, with brief

¹³⁹ *Id.* at Enron document no. ECp000061966. In addition to its work on Enron’s California campaign, Quinn Gillespie and Associates also lobbied the White House on behalf of Enron on other issues, such as the National Energy Policy. *See, e.g.*, E-mail from Ed Gillespie to Andrew D. Lundquist, dated April 3, 2001, 3:47 pm (Office of the Vice President document no. 188); E-mail from Ed Gillespie to Andrew D. Lundquist, dated April 3, 2001, 9:48 am (Office of the Vice President document no. 479).

¹⁴⁰ Enron Corp., “Advancing Electric Competition in the Wake of California; Enron’s Campaign to Affect Policy and Public Opinion,” February 5, 2001 (Enron document nos. ECp000061965-ECp000062027), at Enron document no. ECp000061967.

¹⁴¹ Enron Corp., “Advancing Electric Competition in the Wake of California; Enron’s Campaign to Affect Policy and Public Opinion,” May 4, 2001 (Enron document nos. 000003222-000003237), at Enron document no. ECu000003226.

¹⁴² Letter from Alberto R. Gonzales, Counsel to the President, to The Honorable Joseph I. Lieberman, dated May 22, 2002, Attachment at 2; Letter from Kenneth L. Lay to Clay

(continued...)

biographies of each candidate, including Pat Wood and Nora Brownell. Lay called Johnson twice to follow up on the January 8th letter.¹⁴³ A February 12, 2001 memo to Mr. Lay from Linda Robertson, head of Enron's Washington office, described Enron's priorities in preparation for a call by Mr. Lay to Mr. Johnson concerning "... Commissioner vacancies at FERC." The memo stated that "Enron has strongly supported Pat Wood, a Republican, as Commission Chairman." The memo continued, "(a) number of candidates are said to be under consideration for the second Republican seat at FERC. Enron has on several occasions discussed with transition and now Bush Administration officials the candidacy of Nora Brownell as our first pick for the second open seat." The memo noted that Ms. Brownell was under consideration "on the strength of Enron's interest," but faced competition from another candidate reportedly supported by Pennsylvania Governor Tom Ridge and that Enron was working to "... mitigate the Governor's alleged concerns with her candidacy."¹⁴⁴ In addition, Lay called Senior Advisor to the President Karl Rove to express his support for Nora Brownell's appointment to FERC.¹⁴⁵

Even after Wood and Brownell were nominated, it appeared that Enron's government affairs office continued to push for a quick confirmation of their nominations. In a memo to Lay prior to his April 17, 2001 meeting with the Vice President, Linda Robertson and Tom Briggs, who oversaw federal regulatory affairs for Enron, urged him to "... take the opportunity to convey to the Vice President the imperative of an expedited confirmation of Pat Wood and Nora Brownell." The memo suggested that their appointments would "... mitigate one of the significant political problems confronting passage of the Administration's energy agenda, namely the call by Democrats and Western state members for price caps." It further suggested that these appointments would allow FERC to

'release some of the political steam in the system' by adopting more visible pricing steps in Western markets, such as the bid cap measures in place in Texas and the Northeast ISO. Thus, more aggressive action by the FERC on both market power issues and pricing issues would give the Administration enormous political cover and would allow them to redefine the debate on their own terms.¹⁴⁶

(...continued)

Johnson, dated January 8, 2001 (Executive Office of the President document nos. 980-982).

¹⁴³ Letter from Alberto R. Gonzales, Counsel to the President, to The Honorable Joseph I. Lieberman, dated May 22, 2002, Attachment at 2.

¹⁴⁴ Memorandum from Linda Robertson to Ken Lay, dated February 12, 2001 (Enron document nos. EC 000123909).

¹⁴⁵ Letter from Alberto R. Gonzales, Counsel to the President, to The Honorable Joseph I. Lieberman, dated May 22, 2002, Attachment at 1-2.

¹⁴⁶ Memorandum from Linda Robertson and Tom Briggs to Ken Lay, re: Meeting with Vice President Cheney, dated April 13, 2001, (Enron document nos. EC2 000026045-26105), at (continued...)

According to Ms. Robertson, the confirmations were not actually discussed during the meeting with the Vice President.

Beyond the matter of FERC nominees, Enron executives appeared to bring their message on the California power crisis directly to key Bush Administration officials. On April 5, 2001, Jeffrey Skilling met with Secretary of Treasury Paul O'Neill, and other Treasury Department officials, to discuss the West Coast energy crisis.¹⁴⁷ Ken Lay and Linda Robertson apparently raised the California issue during their 30 minute meeting with the Vice President on April 17, 2001.¹⁴⁸ The White House has indicated that Assistant to the President and Director of the National Economic Council Larry Lindsey had "a few communications" with Ken Lay, "most likely about the California electricity shortage."¹⁴⁹

It is, of course, difficult to evaluate the impact of Enron's far-reaching efforts on decision-making at FERC. As detailed above, for a long time FERC insisted (and to some extent still does insist) that the problems in California were the result of structural flaws in market design and declined to investigate the possibility that there had been abusive behavior on the part of individual energy companies – a position consistent with that advocated by Enron. It is impossible to know how much Enron's lobbying campaign influenced FERC's thinking on this issue and how much FERC was simply predisposed to this view. It should be noted that when the crisis in California became severe, FERC, on June 19, 2001, did ultimately issue an order extending price caps and other mitigation measures to the entire Western market,¹⁵⁰ a decision contrary to one of Enron's stated goals. In response, Enron found it necessary to immediately issue a press release from then-CEO Jeffrey Skilling, reiterating his confidence that price controls would not have an impact on Enron's earning targets for both the second quarter and the year.¹⁵¹

(...continued)

Enron document no. EC2 000026052.

¹⁴⁷ Letter from John Duncan, Assistant Secretary for Legislative Affairs, Department of the Treasury, to Senator Joseph I. Lieberman, Chairman, Committee on Governmental Affairs, dated April 22, 2002, at 1.

¹⁴⁸ Letter from Alberto R. Gonzales, Counsel to the President, to The Honorable Joseph I. Lieberman, dated May 22, 2002, Attachment at 3.

¹⁴⁹ *Id.* at 2.

¹⁵⁰ *San Diego Gas & Electric Co. v. Sellers of Energy Ancillary Service*, 95 F.E.R.C. 61,418 (Order on Rehearing of Monitoring and Mitigation Plan for the California Wholesale Electric Markets, Establishing West-Wide Mitigation, and Establishing Settlement Conference, issued June 19, 2001).

¹⁵¹ "Enron Reiterates Confidence In Operations and Earnings Outlook," Enron Press
(continued...)

Nonetheless, documents reviewed by the Committee show that Enron did aggressively pursue this campaign including contacts with Western governors and regulators and contacts with the Administration to promote the nominations of Nora Brownell and Pat Wood, to discuss the California energy crisis, and to promote open access and competition in electricity markets during the Administration's deliberations on energy policy.

III. CONCLUSION AND RECOMMENDATIONS

For many years, FERC has been at the forefront of the restructuring of the wholesale electricity and natural gas markets from ones based on FERC-determined cost-of-service rates to markets based on competition. Throughout this process, FERC has both recognized the need, and yet inexplicably failed, to establish a framework to effectively regulate the sale and delivery of natural gas and electricity in the new, competitive markets it was creating. The General Accounting Office (GAO)¹⁵² has previously told us as much. And now, Enron provides a striking case study of many of the inadequacies of FERC's current regulatory system – inadequacies that apparently allowed Enron officials to engage in a variety of questionable and, in some cases, allegedly fraudulent financial and commercial transactions at the expense of customers, investors, and competitors.

Although FERC's Chairman has acknowledged some of these structural shortcomings in both formal agency comments to GAO and in an August 12, 2002, letter to Chairman Lieberman, the Committee staff investigation of FERC's interactions with Enron indicates that the proposals being made by FERC do not appear adequate to address the range of regulatory challenges that confront FERC in this new environment – challenges exemplified by Enron Corp. as it aggressively sought to take advantage of the flaws, gaps, and inadequacies in the regulatory system.

One of FERC's chief responses has been to create a new Office of Market Oversight and Investigations (OMOI) dedicated specifically to oversee the electric and natural gas markets.¹⁵³ While it is too early to conclude whether this new office will address the sorts of problems raised by Enron's trading practices and other types of market manipulation that occurred in the

¹⁵¹(...continued)
Release, June 19, 2001.

¹⁵² U.S. General Accounting Office, "Energy Markets: Concerted Actions Needed by FERC to Confront Challenges That Impede Effective Oversight," GAO-02-656, June 2002.

¹⁵³ OMOI was formally created on August 12, 2002. The other initiatives include: promotion of regional transmission organizations, revision of public utility filing requirements, promulgation of standard market design rules, and promoting development of energy infrastructure.

California and Western energy markets, Committee staff seriously doubts that without more it will transform the agency into the proactive, aggressive regulator needed to protect consumers from the greed and subterfuge Enron's collapse revealed.¹⁵⁴

Simply rearranging the bureaucracy, however, is not the answer. FERC must work in concert with other regulatory agencies; it must request and be given sufficient resources to monitor the marketplace and carry out all of its regulatory responsibilities, and it must retool what goes on under its own regulatory roof not only within OMOI, but throughout the agency. Simply put, FERC must reorient itself to a changed and increasingly complex competitive industry – a change that FERC itself has fostered, but failed to adapt to.

Orienting the Mission Toward Proactive Oversight and Enforcement Throughout the Agency

FERC has not institutionally accepted regulation and enforcement as a primary mission, nor has it taken sufficient steps to reassure Committee staff that it will. The new market oversight office, even if staffed sufficiently and run well, is not designed to address problems identified in the Committee staff investigation such as FERC's ineffective handling of the status of Enron's wind farms or its QF certification process generally, or oversight of financial transactions between regulated subsidiaries and holding companies. In other examples of FERC's lax attitude towards its regulatory duties, the agency received an anonymous complaint on April 26, 2002, about pricing practices of Enron's oil pipeline subsidiary, EOTT Partners. The complaint was filed into FERC's information management system without any review by FERC staff, even though the Commission was actively investigating other Enron trading activities.¹⁵⁵ Nor did FERC feel compelled to implement the Federal Civil Penalties Inflation Act as amended by the 1996 Debt Collection Improvement Act, which required it to increase civil penalties. It took a letter from GAO on July 16, 2002, asking about FERC's compliance to jog the agency to action.¹⁵⁶ These are all regulatory functions outside the purview of the new office.

The establishment of the OMOI does not absolve FERC of the responsibility to aggressively address problems throughout its jurisdiction. **If FERC is to be an effective protector, regulator, and overseer of the nation's increasingly deregulated energy**

¹⁵⁴ As part of its effort to strengthen its enforcement activities, FERC has requested that Congress expand its civil and criminal penalty authority under the FPA and Natural Gas Act. We support this request and believe that is important to give FERC additional and/or stronger enforcement tools. We also note, however, that such tools will almost certainly be inadequate without an overall reorientation of the Commission's enforcement efforts.

¹⁵⁵ Unsigned memo to Federal Energy Regulatory Commission, "SUBJECT: Tip on Enron Corp's crude oil price fixing," filed by FERC April 26, 2002.

¹⁵⁶ See Letter from Pat Wood, III, Chairman, FERC, to The Honorable Joseph H. [sic] Lieberman re: FERC's Compliance (RM02-11-000) with the 1990 Federal Civil Penalties Inflation Act, As Amended, dated August 28, 2002.

marketplace, it must recognize the need for a total cultural reorientation of its regulatory approach.

Allocation of Resources

Examining FERC's commitment to enforcement resources is one way to measure its institutional priorities. Yet even in an area FERC claims is a high priority, it falls short. FERC appears to have committed fewer staff and less resources to monitoring and policing the market compared to the efforts of many other independent regulatory agencies.

In his letter to Chairman Lieberman outlining FERC's response to the GAO report, FERC Chairman Wood reported that the Commission had initially transferred 57 employees to the new OMOI office, that it intended also to move attorneys involved in enforcement actions to the new office, and that it was recruiting for additional positions. Altogether, in its FY 2003 budget request, FERC asked for 110 full-time equivalents (FTEs) for the new office and identified a total of 250 FTEs as participating in agency-wide monitoring and enforcement activities.¹⁵⁷ The remaining 140 or more FTEs would be in other offices with responsibilities involving litigation and dispute resolution, rulemakings, identification of data requirements, mergers and other corporate applications, and financial auditing that could broadly be attributed to market monitoring and enforcement.¹⁵⁸

Based on the total number of FTEs requested for the entire agency for FY2003, FERC intends to allocate only 8.8 percent of its FTEs to the OMOI. Even if we assume all 250 FTEs are dedicated to market oversight, 20 percent of the agency's FY2003 FTEs would be committed to broadly defined market oversight and enforcement responsibilities.¹⁵⁹

This resource commitment appears to be less than that of other independent regulatory and enforcement agencies. A review by the Congressional Research Service estimates that the CFTC, SEC and Federal Trade Commission (FTC) have committed FY2003 FTEs of roughly 28

¹⁵⁷ Federal Energy Regulatory Commission, FY2003 Congressional Budget Request and Annual Performance Plan, February 2002; Letter from Pat Wood, III, Chairman, FERC, to the Honorable Joseph H. [sic] Lieberman, re: GAO Report Entitled Energy Markets: Concerted Actions Needed by FERC to Confront Challenges that Impede Effective Oversight, dated August 19, 2002, at 2 and Attachment C.

¹⁵⁸ E-mail from Don Chamblee, FERC, to David Berick, Senate Committee on Governmental Affairs, dated February 25, 2002, and attached memorandum "Response to David Berick Concerning the Need for an Additional \$7 Million and 50 FTEs."

¹⁵⁹ The President's FY2003 Budget Request for the Federal Energy Regulatory Commission requests a total of 1250 FTEs for FERC.

percent, 33 percent, and 60 percent, respectively, of their total agency FTEs to enforcement.¹⁶⁰ The same review reported that the Federal Communications Commission (FCC) allocated approximately 14 percent of its FY2003 FTEs specifically to its Enforcement Bureau and overall dedicated a total of approximately 31 percent of its FTEs to enforcement activities across several bureaus. If we look at budget dollars, FERC intends to devote less than 15% of its FY2003 budget to these activities, whereas the CFTC budgets 28% and the FCC budgets 24%.

Although these interagency comparisons are obviously not precise, they provide at least one indicator of the priority given to enforcement and oversight activities by other federal regulatory agencies. Given the array of problems FERC faces, it does not measure up well. **FERC must devote more resources to market oversight and enforcement.**

Coordination with Other Agencies

As the markets and activities FERC regulates become more complex, they frequently involve the jurisdiction of more than one federal agency. FERC, however, has not made coordination with other agencies a priority.

In the case of SEC-administered PUHCA exemptions, discussed above, that affected the FERC-determined QF status of Enron's wind farms, the SEC and FERC never discussed how to coordinate even the exchange of information concerning exemption requests filed with the SEC. Indeed, even after Southern California Edison petitioned both the SEC and FERC about the status of the wind farms last March and April, there was no interagency communication in response. More fundamentally, FERC and the CFTC have yet to figure out their respective roles in an increasingly sophisticated energy market that involves both physical energy products and commodities futures and other derivatives – whether the issue involves oversight of online trading platforms or some other aspect of the market. Notably, FERC does not even have interagency information or regulatory coordination agreements with either the CFTC or the SEC, nor with other key regulatory or financial agencies. Although interagency agreements are not a necessity for agencies to work together, it is essential that the agencies in fact coordinate. These types of agreements are a basic, first step for such coordination.

Subsequent to Enron's collapse, FERC has begun to take some tentative steps toward improved coordination with other federal agencies. In December, for example, the FERC Chairman sent a letter to the Chairman of the CFTC asking to discuss how the two agencies could better work together, and FERC is currently coordinating its investigation in the California and Western markets with other federal agencies. Nonetheless, this coordination is not routine for the agency nor fully embedded in its understanding of its mission. **FERC must make coordination with other federal regulatory agencies an institutional priority.**

¹⁶⁰ “Enforcement Activities at Selected Federal Agencies,” Congressional Research Service, September 6, 2002.

Intra-Agency Communication

Finally, this memorandum has highlighted a number of instances where important information developed or uncovered by staff in one part of the agency has not made its way to other parts of the agency or to the Commission. A failure to communicate or share important information within the agency is a failure to perform the basics of the job.

One example is the FERC staff's Enron Online report which looked at Enron's highly leveraged financial condition but was not given to the Commissioners even as Enron was collapsing. Another example, with perhaps even clearer consequences, relates to the Commission's consideration of how to calculate refunds to consumers in the California electricity market. At the same time the Commission was deliberating on this matter, there were two FERC staff inquiries examining directly relevant issues. The first was the Enron Online inquiry which looked at published price indices and ultimately concluded that they were unreliable. The second was a series of audits conducted by the Office of the Chief Accountant examining the cost of generating the electricity that was being sold by individual companies into the California market; a memo was even written by the Chief Accountant to the Chief of Staff and other senior managers at FERC stating that information contained in the audits would likely be of value to those working on the refund matter.¹⁶¹ Yet, Committee staff found that none of this information was presented to the Commission nor made available to participants in the refund proceeding. The reliability of the Commission's preferred refund methodology has subsequently been brought into question; indeed, the FERC staff's 2002 initial report on the California markets has recommended that the refund methodology be revised because it's based on faulty price indices. This will likely result in further delays in getting deserved refunds to consumers.

Having capable staff able to ask the right questions is critical, but will not solve FERC's problems if the information the staff uncovers does not make its way to the Commission and others at the agency who can make use of it. **FERC must improve its internal coordination of staff activities and communication with the Commissioners themselves.**

Conclusion

FERC's experience with Enron demonstrates that the agency is no match for the sophisticated, competitive, profit-driven companies it regulates. Although the creation of OMOI is a positive development, unless it is adequately and appropriately staffed and supplemented with more aggressive regulatory efforts throughout the Commission, it is unlikely to succeed in transforming FERC into the effective market overseer it needs to be.

¹⁶¹ Memorandum from John M. Delaware, Deputy Executive Director and Chief Accountant to Walter C. Ferguson, Chief of Staff, Daniel L. Larcamp, Director, Office of Markets, Tariffs and Rates, and Kevin P. Madden, General Counsel on "Audit of the Component Costs of Generating Electric Power," undated, at 1 (according to FERC staff, the memo was prepared on July 20, 2001).

FERC must do far more to be vigilant, to incorporate an aggressive enforcement ethic into its everyday work, to effectively coordinate with other agencies, and to ensure that relevant information is made available to those who need it in order for FERC to fulfill its mission and to protect consumers and investors in the increasingly complex and continually evolving energy markets.

Schedule MRY 4

Matthew Young

Central Rivers Wastewater Utility Inc

Case No SR-2014-0247

CSM Charge Analysis

Source 1: DR 1 #9 - CSM 2014 Contract

Source 2: Division of Occupational Employment Statistics - U.S. Bureau of Labor Statistics

Comparison of Construction Services & Management ("CSM") charges to Market Value of Wages

A	B	C	D	E	F	G	H
Description	Market Value Hourly Pay Rate	Company Estimated Hours Allocated to Service	Overhead Markup	Profit Margin ¹	Market Value of Rates with Profit B*C*D*(1+E)	Annualized CSM Charges	Excess of Contractual Charges Over Market Value
Service Calls		As Needed	1.50	9.04%	\$ 6,338	\$ 3,875	\$ (2,463)
Maintenance	\$22.77	330	1.50	9.04%	12,290	19,800	7,510
Customer STEP Maint	\$22.77	482	1.50	9.04%	17,951	28,920	10,969
Mowing	\$22.77	245	1.50	9.04%	9,125	14,700	5,575
Clerical	\$16.19	557	1.50	9.04%	14,753	19,500	4,747
Management	\$57.11	144	1.50	9.04%	13,451	10,800	(2,651)
Monitoring	\$22.77	384	1.50	9.04%	14,301	23,040	8,739
Cleaning	\$22.77	84	1.50	9.04%	3,128	5,040	1,912
					\$ 91,338	\$ 125,675	\$ 34,337

¹Percent updated during the disposition period to reflect Staff's latest recommendation.

Missouri Public Service Commission

Respond Data Request

Data Request No.	0015
Company Name	Central Rivers Wastewater Utility, Inc.-(Sewer)
Case/Tracking No.	SR-2014-0247
Date Requested	6/12/2014
Issue	General Information and Miscellaneous - Company Information
Requested From	Mark Geisinger
Requested By	Kevin Thompson
Brief Description	Affiliated Company Information
Description	Identify the Construction Services & Management revenues billed and collected from a) Central Rivers b) all non-Central Rivers entities for 2011, 2012, 2013 and monthly for 2014 broken out for the various charges made to a) Central Rivers b) all non-Central Rivers entities for each of the services provided. DR requested by Matthew Young (Matthew.Young@psc.mo.gov).
Response	The following table breaks down the amount billed each year by Construction Services and the actual amount collected. As you can see the outstanding balance each year is the debt owed to Construction Services by Central Rivers that we have previously discussed and is not being recognized as such. Year Billed Collected Outstanding Balance 2011 \$105,622.25 \$52,393.50 \$53,228.75 2012 \$113,353.00 \$16,898.00 \$96,455.00 2013 \$112,242.50 \$84,850.00 \$27,392.50 2014 \$79,300.00 \$58,116.00 \$21,184.00 Total Outstanding\$198,260.25
Objections	NA

The attached information provided to **Missouri Public Service Commission** Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the **Missouri Public Service Commission** if, during the pendency of Case No. **SR-2014-0247** before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information. If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the **Central Rivers Wastewater Utility, Inc.-(Sewer)** office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to **Central Rivers Wastewater Utility, Inc.-(Sewer)** and its employees, contractors, agents or others employed by or acting in its behalf.

Security :	Public
Rationale :	NA

Missouri Public Service Commission

Respond Data Request

Data Request No.	0019
Company Name	Central Rivers Wastewater Utility, Inc.-(Sewer)
Case/Tracking No.	SR-2014-0247
Date Requested	6/12/2014
Issue	General Information and Miscellaneous - Company Information
Requested From	Mark Geisinger
Requested By	Kevin Thompson
Brief Description	Affiliated Company Information
Description	a. Provide all revenues for Construction Services & Management broken out between those received from Central Rivers and those received from other non-Central Rivers entities for 2011, 2012, 2013 and each month through 2014. b. Provide all costs/ expenses incurred by Construction Services & Management to provide services to Central Rivers and to other non-Central Rivers entities for 2011, 2012, 2013 and each month through 2014 broken out by category of costs/ expenses. DR requested by Matthew Young (Matthew.Young@psc.mo.gov).
Response	Central Rivers Wastewater Utility, Inc. does not have access to that information.
Objections	NA

The attached information provided to **Missouri Public Service Commission** Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the **Missouri Public Service Commission** if, during the pendency of Case No. **SR-2014-0247** before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information. If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the **Central Rivers Wastewater Utility, Inc.-(Sewer)** office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to **Central Rivers Wastewater Utility, Inc.-(Sewer)** and its employees, contractors, agents or others employed by or acting in its behalf.

Security :	Public
Rationale :	NA

Missouri Public Service Commission

Respond Data Request

Data Request No.	0013
Company Name	Central Rivers Wastewater Utility, Inc.-(Sewer)
Case/Tracking No.	SR-2014-0247
Date Requested	5/27/2014
Issue	Tariff Issue - Other Tariff Issues
Requested From	Mark Geisinger
Requested By	Kevin Thompson
Brief Description	Breakdown of Actual Costs Incurred in Connecting a STEP system to the Sewer Main
Description	Please provide a detailed item-by-item breakdown, with supporting documentation, of all costs incurred in connecting a STEP system to the sewer main (i.e. the cost, in dollars, of watertight septic tank, post construction testing of tank and system, pump or pumps, effluent filters, electrical control panel, splice box and wiring from control panel to septic tank, wiring from stubbed out electrical service at customer home to control panel, piping from single family residence to septic tank, piping from septic tank to main collection system line, risers and lids, service connection valves and appurtenances, inspections, etc.) Data Request submitted by William Harris (william.harris@psc.mo.gov).
Response	We have attached an estimate from Construction Services outlining the details of a \$6,000.00 STEP system installation.
Objections	NA

The attached information provided to **Missouri Public Service Commission** Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the **Missouri Public Service Commission** if, during the pendency of Case No. **SR-2014-0247** before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information. If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the **Central Rivers Wastewater Utility, Inc.-(Sewer)** office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to **Central Rivers Wastewater Utility, Inc.-(Sewer)** and its employees, contractors, agents or others employed by or acting in its behalf.

Security :	Public
Rationale :	NA

Please provide an adequate response to DR 13, specifically addressing the issues noted above. Staff will expect to see some form of expanded response to the Company's initial response. An example could be something like:

Materials:	Riser lid	\$\$\$	(accompanied by a dated receipt or invoice)
	Riser	\$\$\$	(accompanied by a dated receipt or invoice)
	Riser plate	\$\$\$	(accompanied by a dated receipt or invoice)
	1500 gallon concrete tank	\$\$\$	(accompanied by a dated receipt or invoice)
	Electrical splice box	\$\$\$	(accompanied by a dated receipt or invoice)
	Control panel	\$\$\$	(accompanied by a dated receipt or invoice)
	<u>(and so on and so on accompanied by dated receipts or invoices until all the material are listed)</u>		
	Total cost of materials	\$\$\$	
Labor:	Mobilization fee	SSS	(with receipt, invoice, description or explanation)
	Locates and office support	SSS	(with receipt, invoice, description or explanation)
	Plumber	SSS	(with receipt, invoice, description or explanation)
	Laborer	SSS	(with receipt, invoice, description or explanation)
	<u>Backhoe with operator</u>	<u>SSS</u>	<u>(with receipt, invoice, description or explanation)</u>
	Total cost of labor	\$\$\$	
Insurance and Fuel Surcharge (for what?)	_____	_____	<u>(with description, explanation and/or calculation)</u>
	Total cost of STEP installation	_____	_____

Based on data received to date, Staff cannot support, nor recommend to the Commission, any installation amount larger than the \$4800 in the Company's current approved tariff.

Missouri Public Service Commission

Respond Data Request

Data Request No.	0013.1
Company Name	Central Rivers Wastewater Utility, Inc.-(Sewer)
Case/Tracking No.	SR-2014-0247
Date Requested	7/22/2014
Issue	Tariff Issue - Other Tariff Issues
Requested From	Mark Geisinger
Requested By	Kevin Thompson
Brief Description	Breakdown of Actual Costs Incurred in Connecting a STEP system to the Sewer Main
Description	The Company's response to DR 13 is insufficient or inadequate in the following ways: 1. It does not provide a detailed item-by-item breakdown of all costs. 2. It does not provide supporting documentation (i.e. receipts, invoices, etc.) for the actual cost of each item. 3. It does not provide specific costs incurred in an actual installation (only an estimate of what general cost will likely be incurred). PLEASE SEE ATTACHED.
Response	Attached please find a price breakdown of the material and labor prices incurred for the STEP System Installation & Connection to Sewer Main. We are currently working to collect the supporting documentation you require.
Objections	NA

The attached information provided to **Missouri Public Service Commission** Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the **Missouri Public Service Commission** if, during the pendency of Case No. **SR-2014-0247** before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information. If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the **Central Rivers Wastewater Utility, Inc.-(Sewer)** office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to **Central Rivers Wastewater Utility, Inc.-(Sewer)** and its employees, contractors, agents or others employed by or acting in its behalf.

Security :	Public
Rationale :	NA

STEP System Installation & Connection to Sewer Main – Price Breakdown

<u>Material</u>	<u>Price</u>
1500 Gallon Concrete Tank	930.00
Riser Lid	45.00
Riser	40.00
Riser Plate	44.00
Electrical Splice Box	65.00
Control Panel	310.00
1" Grommet	4.10
Control Float	48.00
Alarm Float	48.00
Pump Vault	485.00
Effluent Pump	427.50
4' of ¾" Conduit	3.71
2: ¾" Conduit Male Adapters	8.36
45' of 4" PVC Pipe	71.60
1: 4" Cap	7.71
1: 4" Wye	5.12
1: 4" Cleanout w/Cap	6.59
3: 4" 45's	12.24
220' of 1" PVC Pipe	100.00
5: 1" 90's	6.25
1: 1" Ball Valve	5.64
1: 1" Check Valve	8.95
1: 1" Union	4.86
1¼" x 1" Bushing	2.13
2x1 Tapping Saddle	38.22
6' of 6" Riser Pipe	29.00
60' of 12/3 Direct Bury Wire	48.00
60' of 14/3 Direct Bury Wire	33.00
Glue & Rectorseal	6.44
Total Materials	2844.42

<u>Labor</u>	<u>Fee</u>
Mobilization Fee	225.00
Locates & Office Support (4 Hrs @ \$35/Hr)	140.00
Plumber & Operator – Installation (16 Hrs @ \$60/Hr)	960.00
Backhoe (16 Hrs @ \$85/Hr)	1360.00
Start Up (4 Hrs @ \$60/Hr)	240.00
Total Labor	\$2925.00

Materials	2844.42
Labor	2925.00
Insurance & Fuel Surcharge	230.58
GRAND TOTAL	\$6000.00

Missouri Public Service Commission

Respond Data Request

Data Request No.	0013.1
Company Name	Central Rivers Wastewater Utility, Inc.-(Sewer)
Case/Tracking No.	SR-2014-0247
Date Requested	7/22/2014
Issue	Tariff Issue - Other Tariff Issues
Requested From	Mark Geisinger
Requested By	Kevin Thompson
Brief Description	Breakdown of Actual Costs Incurred in Connecting a STEP system to the Sewer Main
Description	The Company's response to DR 13 is insufficient or inadequate in the following ways: 1. It does not provide a detailed item-by-item breakdown of all costs. 2. It does not provide supporting documentation (i.e. receipts, invoices, etc.) for the actual cost of each item. 3. It does not provide specific costs incurred in an actual installation (only an estimate of what general cost will likely be incurred). PLEASE SEE ATTACHED.
Response	Attached please find a cover letter along with the requested supporting documentation for STEP system installation. We have also included two comparison bids for the services Construction Services provides.
Objections	NA

The attached information provided to **Missouri Public Service Commission** Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the **Missouri Public Service Commission** if, during the pendency of Case No. **SR-2014-0247** before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information. If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the **Central Rivers Wastewater Utility, Inc.-(Sewer)** office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to **Central Rivers Wastewater Utility, Inc.-(Sewer)** and its employees, contractors, agents or others employed by or acting in its behalf.

Security :	Public
Rationale :	NA

September 23, 2014

Missouri Public Service Commission
PO Box 360
Jefferson City, Missouri 65102

CENTRAL RIVERS RATE REVIEW AUDIT
FILE NO. SR-2014-0247
ADDITIONAL INFORMATION

STEP System Vendor Receipts

The PSC has requested copies of the vendor receipts where materials are purchased for the STEP systems. Central Rivers has attached an itemized listing of the materials and labor required for installation of each STEP system along with receipts from the vendors where Construction Services purchases their materials. There are 5 receipts: SI Precast, Pyramid Pipe & Supply, Neenan Company, Nuts & Bolts and Gravel.

Bids for Contract Services

Central Rivers has requested comparative pricing bids from four companies. We have received bids from two of the companies and have attached them: Collins Plumbing and All R's Construction LLC. Once Central Rivers receives the remaining bids we will provide them as well.

Please feel free to contact me at (816) 898-1454 with any questions or concerns.

Sincerely,

Mark Geisinger
CENTRAL RIVERS WASTEWATER UTILITY, INC.

Attachments - 10 pages

STEP System Installation & Connection to Sewer Main – Price Breakdown

<u>Material</u>	<u>Price</u>
1500 Gallon Concrete Tank	980.00
Riser Lid	45.00
Riser	60.00
Riser Plate	24.00
Electrical Splice Box	55.00
Control Panel	325.00
1¼ " Grommet	4.10
Control Float	48.00
Alarm Float	48.00
Pump Vault	485.00
Effluent Pump	427.50
10' of ¾" Conduit	1.99
2: ¾" Conduit Male Adapters/w lock, 3/4" LB	8.55
40' of 4" PVC Pipe	82.00
1: 4" Cap	6.27
1: 4" Wye	12.46
1: 4" Cleanout w/Cap	6.27
3: 4" 45's	17.15
220' of 1¼" PVC Pipe	114.40
20' of 1" PVC pipe	7.80
5: 1" 90's	2.58
1: 1" Ball Valve	16.40
1: 1" Check Valve	14.39
1: 1" Union	2.96
1¼" x 1" Bushing	1.74
3 x 1½ Tapping Saddle	83.64
10' of 6" Riser Pipe	28.20
80' of 12/3 Direct Bury Wire	79.20
80' of 14/3 Direct Bury Wire	47.20
Glue & Rectorseal	9.09
1: 6" valve riser sewer lid	39.36
Subtotal	3083.25
Tax (7.975%)	245.89
Total Materials	3329.14

<u>Labor</u>	<u>Fee</u>
Mobilization Fee	225.00
Locates & Office Support (2.61 Hr @ \$35/Hr)	91.36
Plumber & Operator – Installation (15 Hrs @ \$60/Hr)	960.00
Backhoe (10 Hrs @ \$85/Hr)	850.00
Start Up (2 Hrs @ \$60/Hr)	120.00
Total Labor	2246.36

STEP System Installation & Connection to Sewer Main – Price Breakdown

Total Materials	3329.14
Rock for bedding (rock & delivery)	399.50
Total Labor	2246.36
Fuel Surcharge – Si Precast	25.00
GRAND TOTAL	6000.00



GRANDVIEW LOCATION
11919 CARTWRIGHT
GRANDVIEW, MO 64030
PHONE: 816-966-9000
FAX: 816-966-8488

Del.
OCT-1-14

CUSTOMER INFORMATION Lot 47 Private Gardens DATE 9-22-14
 NAME Construction Services PHONE _____
 ADDRESS _____ CITY _____ STATE _____

QTY: Will Call with Dir.
Week of 9-29

QTY: PAID CHECK # 3097
9-22-14

RISERS & LIDS

- 1 715516 24" STANDARD POLYLOK LID \$ 0
- 1 715501 24" POLYLOK LID \$ 45.00
- 714055 20" POLYLOK LID \$ _____
- 714510 20" POLYLOK 12" LIFT \$ _____
- 714050 30" ROUND LID W/POLYLOK RISE \$ _____
- 715515 30" LID W/24" POLYLOK RISER \$ _____
- 714050 20" x 6" POLYLOK RISER \$ _____
- 2 715515 24" x 12" POLYLOK RISER \$ 60.00
- 715514 24" x 6" POLYLOK RISER \$ _____
- 1 715517 POLYLOK RISER PLATE \$ 20.00
- 703058 24" SQUARE LID \$ _____
- 703048 24" SQUARE RISER \$ _____

PUMPS

- 711054 1/3 HORSE WEO311M GOULD PUMP \$ _____
- 711052 1/2 HORSE WEO511H GOULD PUMP \$ _____
- 711052 1/2 HORSE WEO511HH GOULD PUMP \$ _____
- 711013 3/4 HORSE WEO712H GOULD PUMP \$ _____
- 715100 4" STA-RITE 1/2 HP 20 GPM 115V \$ _____
- 715101 HIGH HEAD 1/2 HP 20 GPM 115V STEP \$ _____
- 1-715116 STA RITE Pump 427.50

FLOATS & CONTROLS

- 715300 ALARM PANEL INDOOR MOUNT \$ _____
- 715301 OUTDOOR HIGH WATER ALARM \$ _____
- 1 715302 SPLICE BOX 4-CORD GRIP \$ 55.00
- 1 715305 SIMPLEX PANEL 115V MANUAL ON/OFF \$ 325.00
- 715306 SIMPLEX PANEL 115V TIME DOSED \$ _____
- 715314 FLOAT TREE MOUNTING BRACKET \$ _____
- 715316 DBL FLOAT 110 \$ _____
- 715317 DBL FLOAT 220 \$ _____
- 1 715303 FLOAT -A- SIGNAL FLOAT \$ 48.00
- 715304 FLOAT -B- MOTOR RATED MECHANICAL \$ _____
- 1 715318 JUNIOR SUPER SINGLE FLOAT \$ 48.00
- 715010 AQUAWORX REMEDIATOR \$ _____
- 1 - mis Sim Tank
PUMP VAULT 425.00

WE HANDLE A FULL LINE OF DELTA FIBERGLASS PRODUCTS. PLEASE CALL FOR PRICING AND DELIVERY.

DELIVERY CHARGE

FIRST 30 MILES FREE DELIVERY
EACH ADDITIONAL MILE AFTER 30 MILES
\$3.25 PER LOAD

SUBSURFACE DRIP SYSTEMS

- 715200 GEO-FLOW WASTEFLOW PC 24" SPACING \$ _____
- 715201 GEO-FLOW WASTEFLOW PC 12" SPACING \$ _____
- 715202 GEO-FLOW CLASSIC 24" SPACING \$ _____
- 715203 SPIN CLEAN FILTER 1" W/VALVE 150 MESH \$ _____
- 715204 SPIN CLEAN FILTER 1 1/2" W/VALVE 150 MESH \$ _____
- 715205 1" BLACK 150 MESH SCREEN \$ _____
- 715206 1 1/2" BLACK 150 MESH SCREEN \$ _____
- 715207 WATERPROOF 0-100 PSI GAUGE \$ _____
- 715208 AIR/VACUUM RELIEF VALVE W/SHRADER \$ _____
- 715209 1" PVC STREET ELL SPGZFIPT \$ _____
- 715210 PVC TEE 1" x 1" x 1/2" SLIP \$ _____
- 715211 7" FLUSHING VALVE W/FIBERGLASS LID \$ _____
- 715212 COUPLING FITS 1/2" WASTEFLOW DRIPLINE \$ _____
- 715213 1/2" SLIP x 1/2" WASTEFLOW DRIPLINE \$ _____
- 715215 1/2" SUPER FLEX SPA TUBING 100' ROLL \$ _____
- 715216 AMIAD FILTER \$ _____
- 712520 MODEL 1100 FILTER ASSEMBLY \$ _____
- 712585 PRESSURE GAUGE ASSEMBLY \$ _____

SEPTIC TANKS

- 712730 600 GPD DELTA UNIT \$ _____
- 1 701010 1500 GALLON SINGLE \$ 980.00
- 701025 1500 GALLON DUAL \$ _____
- 701040 1250 GALLON SINGLE \$ _____
- 701055 1250 GALLON DUAL \$ _____
- 701060 1000 GALLON SINGLE \$ _____
- 701065 1000 GALLON DUAL \$ _____
- 701090 500 GALLON SINGLE \$ _____

WASTEWATER ACCESSORIES

- 1 715600 1" GROMMET \$ 4.00
- 715601 1 1/4" GROMMET \$ _____
- 715602 2" GROMMET \$ _____
- 715603 EFFLUENT SCREEN W/FLOW INDUCER \$ _____
- 715604 EFFLUENT FILTER (RESIDENTIAL) \$ _____
- 715605 K-RAIN 4000 WASTEWATER VALVE \$ _____
- 715606 K-RAIN 6000 WASTEWATER VALVE \$ _____
- 715607 TABLET CL2 TUBE \$ _____
- 715608 BULL RUN VALVE \$ _____
- 715609 DISTRIBUTION BOX \$ _____
- 715610 1" OFFICE SHIELDS \$ _____

Fuel
charge
25.00

Sub Total \$ _____
Tax \$ 206.50
Total \$ 1,728.10

Notes



Free Delivery
Parts Counter
Plumbing Showroom

SALES ORDER

tel: 816-966-8924 toll free: 877-966-8924
fax: 816-966-9139

www.pyramidpipeandsupply.com
3800 Main Street Grandview, Missouri 64030

Sales Order No.: 144545
Sales Order Date: 09/19/14
Due Date: 09/19/14
Customer No.: C9006
Customer Ref. No.: LOT 47 PRIVATE GARDEN
Page No.: Page 1 of 1

BILL TO

CASH CUSTOMER

SHIP TO

GRANDVIEW
CONSTRUCTION SERVICES
MARK GEIRSINGER
8.898.1454

Sales Employee: Diefenbach, Don
Contact Name:

Terms: - Cash Basic -
Ship Via:

Item No.	Mfg No.	Description	QTY	Ship	B/O	Unit Price	Total
060-004000		PVC PIPE SCH 40 PRESSURE PE 4" X 20'	40	40		\$ 2.0500	\$ 82.00
082-454000	447-040	PVC PRESSURE SCH40 CAP SLIP 4"	1	1		\$ 6.2680	\$ 6.27
067-454000	192304L	PVC DWV WYE 4"	1	1		\$ 12.4583	\$ 12.46
067-114000	192894	PVC DWV FEMALE 4"	1	1		\$ 4.2593	\$ 4.26
067-154000	193054S	PVC DWV PLUG 4"	1	1		\$ 2.0115	\$ 2.01
067-294000	192504	PVC DWV 45° 4"	3	3		\$ 5.7173	\$ 17.15
082-011000	406-010	PVC PRESSURE SCH40 90° 1"	5	5		\$ 0.5160	\$ 2.58
125-951000	2412-010W	BALL VALVE PVC (W/ UNION) 1" SLIP	1	1		\$ 16.4000	\$ 16.40
320-500013	KSC-1250-S	SWING CHK NDS SOLVENT WELD 1-1/4	1	1	1	\$ 14.3850	\$ 14.39
082-410249	437-168	PVC PRESSURE SCH40 BUSHING SLIP 1-1/4" X 1"	2	2		\$ 0.6560	\$ 1.31
082-651000	457-010	PVC PRESSURE SCH40 UNION 1"	1	1		\$ 2.9560	\$ 2.96
082-390249	436-168	PVC PRESSURE SCH40 MALE x SLIP 1-1/4" X 1"	1	1		\$ 1.7360	\$ 1.74
060-356001		PVC PIPE COEX SCH 40 PE 6" X 10'	10	10		\$ 2.8200	\$ 28.20
060-011250		PVC PIPE SCH 40 SOLID BE 1 1/4" X 20'	220	220		\$ 0.5200	\$ 114.40
082-331250	435-012	PVC PRESSURE SCH40 FEMALE ADAP 1-1/4"	3	3		\$ 0.6560	\$ 1.97
900-000090		SPEARS FLO-TAP 3" X 1-1/2" (2" SPIG.)	1	1	1	\$ 83.6400	\$ 83.64
082-410299	437-212	PVC PRESSURE SCH40 BUSHING SLIP 1-1/2" X 1-1/4"	1	1		\$ 0.6960	\$ 0.70
ZZDEL		USPS/UPS/SHIPPING & HANDLING	1	1		\$ 15.0000	\$ 15.00
201-210003	OATEY 30893	PVC GLUE BLUE RAIN/SHINE PINT	1	1		\$ 9.0900	\$ 9.09

Based On Sales Quotations 48087.

*Paid
Visa*

Subtotal \$ 416.53
Discount
Shipping
Tax \$ 32.02
Total Order Value \$ 448.55

Signed By: _____

*** DUPLICATE RECEIPT ***
 THANK YOU FOR SHOPPING AT
 NUTS AND BOLTS
 11200 ANTIOCH ROAD
 OVERLAND PARK, KS 66210
 (913) 322-2658

09/22/14 8:29AM JF22 152 SALE

233965	80 EA	.59 EA	47.20
250' 14/2 W/G UF Cable	80 EA	.99 EA	79.20
234377	1 EA	1.99 EA	1.99
250' 12/2 W/G UF Cable	1 EA	1.29 EA	1.29
420232	1 EA	.99 EA	1.98
3/4x10 Sch40 Conduit	2 EA	3.99 EA	3.99
350394	1 EA		
2PK 3/4" Conduit Locknut			
425348			
3/4" PVC Term Adapter			
427237			
3/4" LB Access Fitting			
SUB-TOTAL:	135.65	TAX:	11.53
		TOTAL:	147.18
		BC AMT:	\$147.18

BK CARD#: XXXXXXXXXXXX8114
 ID: 062207076993360535
 AUTH: 004486 AMT: 147.18
 Host reference #: 000019 Bat#
 MANUAL EXPR: XXXX
 CARD TYPE: VISA



==>> JRNL#F68208 <<==
 CUST # *6

Acct: CASH CUSTOMER
 PO#: LOT47
 REF: PO # LOT47

*** DUPLICATE RECEIPT ***
 Ship to: GEISINGER/MARK
 Ref: PO # LOT47

----- COUPON -----

Please tell us about your visit.
 Take the brief survey at
www.shopnutsandbolts.com/survey. Provide
 your email address and receive a
 coupon for \$5 off \$25 purchase.

----- COUPON -----
 Customer Copy

NEENAN COMPANY



S2142275-000
 P.O. BOX 308408
 KANSAS CITY, MO 64130
 (816) 923-1300 FAX (816) 923-4411

ORDER# : S2142275.000
 P.O.# :
 PRINTED : 13:03:34 22 SEP 2014
 PAGE# : 1 of 1

B

SOLD TO:
 CASH SALES MAIN OFFICE
 KANSAS CITY, MO 64130

SHIPTO:
 CASH SALES MAIN OFFICE
 KANSAS CITY, MO 64130

** C.O.D. ** C.O.D. ** C.O.D. **

**** Acknowledgement ****

ORDERED BY	ORDER DATE 09/22/14	SHIP DATE 12/04/14	SHIP VIA PK PICK-UP	WAREHOUSE Shp 1 Prc 1
WRITER PATRICK NEENAN	SALESPERSON Cash Sales		RELEASE #	FREIGHT ALLOWED NO

ORDERED	SHIPPED	PRODUCT DESCRIPTION		
Lea		C&B F2194 VALVE BOX FOR 6" PIPE WITH SEWER LID	36.330	36.33

SUBTOTAL	36.33
SALES TAX	3.03

Total Amount	39.36
Less cash paid	-39.36

** AMOUNT DUE **	0.00

COOK
 10295
 McAfee Rd. Oriskany N.Y. 270988
 64077

CUSTOMER'S ORDER NO.		DATE	
		9-22-14	
NAME Const Services + Maintenance			
ADDRESS Tulahoma Est. Rd 47			
CITY, STATE, ZIP			
SOLD BY	CASH	C.O.D.	CHARGE
			ON. ACCT.
			MDSE. RETD.
			PAID OUT
QUAN.	DESCRIPTION	PRICE	AMOUNT
1	14.97 ton 3/4	10.00	149.70
2	Haul		
3	Richmond To 92		250.00
4	Heavy		
5			
6			
7			
8			
9			
10			
11			
12			
			399.70
RECEIVED BY			

A-4705
T-46526

KEEP THIS SLIP FOR REFERENCE

01-11

COLLINS PLUMBING, LLC
PO BOX 944 LEES SUMMIT, MO 64063

(816) 419-7731

We appreciate the opportunity to work with Central Rivers Waste Water Utility Inc.

September 17, 2014

Central Rivers Wastewater Utility, Inc.'s has seven sewer plants in the following locations:

- o Berkshire Glen at NE 120th Street, 300 Feet West of Hills Road, Kearney MO 64060 in Clay County
- o Country Hill Estates at 10500 Northeast US Highway 69 Cameron, MO in Clinton County
- o Countryside Meadows at Hill Side Circle, Orrick MO 64077 in Ray County
- o Fox Run at Intersection of Hills Road & 147th Street, Kearney MO 64060 in Clay County
- o Park Estates at End of 170th Street West of Highway 33, Kearney MO 64060 in Clay County
- o Private Gardens at NE 118th Street, 1/5 West of Plattsburg Road, Kearney MO 64060 in Clay County
- o Wilmar Estates at Missouri State Route 92 & Highway A Liberty MO 64068 in Clay County

Please provide an estimate to provide the following services for the seven sewer plants.

<u>Service</u>	<u>Price</u>
Provide service calls on an as-needed basis. Please provide price for first hour and then each additional hour.	Service call \$172.00 Add. Hr \$68.00
Monthly monitoring and maintenance of sewer plants. This includes a weekly visit to each facility, cleaning filters, checking control panels and alarms, drawing of water samples, delivery of samples to lab and sending reports for each plant to DNR.	\$2720.00
Yearly cleaning and inspection of each customer's collection equipment. This includes all customers in all subdivisions listed above. Approximately 270 customers currently. Please price per home.	\$172.00 each
Monthly mowing and weed control of all sewer plants during the mowing season.	No bid
Monthly clerical duties, including all receivable tasks.	\$2400.00
Monthly monitoring of Wilmar and Private Gardens. An increase of services for new operational guidelines. These two subdivisions fall under guidelines designated by DNR for systems operated above 200 P.E. This will require a daily visit by a Class C operator at each location.	\$3264.00
Quarterly cleaning of filters and sand filter piping at each sewer plant.	\$2156.00
Step installation and service line to sewer main	\$6700.00





ALL Rs Const. LLC

P.O. BOX 335
KEARNEY MO.
64060

Central Rivers Wastewater Utility Inc.
1201 Commercial Drive Suite 5
Excelsior Springs Mo. 64024

I have reviewed your request for bid and have the ability to take care of everything except the clerical duties. Thank you for the opportunity and I look forward to working with Central Rivers Wastewater Utility Inc.

September 17, 2014

Central Rivers Wastewater Utility, Inc.'s has seven sewer plants in the following locations:

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- o Private Gardens at NE 118th Street, 1/5 West of Plattsburg Road, Kearney MO 64060 in Clay County
- o Wilmar Estates at Missouri State Route 92 & Highway A Liberty MO 64068 in Clay County

Please provide an estimate to provide the following services for the seven sewer plants.

<u>Service</u>	<u>Price</u>
Provide service calls on an as-needed basis. Please provide price for first hour and then each additional hour.	Service call \$145.00 Add. Hr \$62.50
Monthly monitoring and maintenance of sewer plants. This includes a weekly visit to each facility, cleaning filters, checking control panels and alarms, drawing of water samples, delivery of samples to lab and sending reports for each plant to DNR.	\$1800.00
Yearly cleaning and inspection of each customer's collection equipment. This includes all customers in all subdivisions listed above. Approximately 270 customers currently. Please price per home.	\$130.00 each
Monthly mowing and weed control of all sewer plants during the mowing season.	\$2000.00

Monthly clerical duties, including all receivable tasks.	No bid
Monthly monitoring of Wilmar and Private Gardens. An increase of services for new operational guidelines. These two subdivisions fall under guidelines designated by DNR for systems operated above 200 P.E. This will require a daily visit by a Class C operator at each location.	\$2320.00
Quarterly cleaning of filters and sand filter piping at each sewer plant.	\$1890.00
Step installation and service line to sewer main	\$6500.00

Raymond Robertson

