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June 25, 2018

Waylene Hiles, Director
Joint Committee on Administrative Rules
State Capitol, Room B8
Jefferson City, Missouri 65101

Sarah H. Steelman
Commissioner
Office of Administration
Commissioner's Office
Capitol Building, Room 125
P.O. Box 809
Jefferson City, Missouri 65102

Dear Ms. Hiles and Ms. Steelman

Re: Notice of Receipt of Petition to Promulgate Rules – Commission File No. WX-2018-0387

As required by Section 536.041, RSMo 2016, the Missouri Public Service Commission informs you that on June 22, 2018, the Office of the Public Counsel filed a petition asking the Commission to promulgate a rule to govern affiliate transactions by and among water utilities. The Commission will consider Public Counsel's petition and may take further action as appropriate. In compliance with the statute, I have attached a copy of the rulemaking petition.

Sincerely,

Morris L. Woodruff
Secretary/Chief Regulatory Law Judge

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

In the Matter of the Request for a Workshop)	
And Motion to Open a Rulemaking)	
Docket of the Office of the Public Counsel)	File No. WX-2018-XXXX
Pertaining to the Affiliate)	
Transactions of Water Corporations)	

**REQUEST FOR A WORKSHOP AND
MOTION TO OPEN A RULEMAKING DOCKET**

COMES NOW Office of the Public Counsel (OPC), by and through counsel, and, pursuant to Section 386.250, RSMo; Section 386.710, RSMo; Section 393.140, RSMo; Section 536.046, RSMo; Section 536.041, RSMo; and, Missouri Public Service Commission (Commission) Rule 4 CSR 240-2.180, respectfully states as follows to the Commission:

BACKGROUND INFORMATION

1. The OPC is a Missouri state agency within the Department of Economic Development. The OPC's office is located at Governor's Office Building, Suite 650 Jefferson City, MO 65101.

2. The OPC is directed by Section 386.710, RSMo to "represent and protect the interests of the public" before the Commission.

MOTION FOR RULEMAKING DOCKET

3. The Commission is empowered under Section 386.250, RSMo to consider rules prescribing the conditions and rendering of public utility service.

4. Under section 393.140(4), RSMo, the Commission is concurrently authorized to prescribe uniform record and account keeping measures for water corporations.

5. Under section 536.046, RSMo, the Commission is authorized to initiate and maintain a rulemaking docket.

6. Section 536.041, RSMo, endows any person, including the OPC, to initiate the rule making process.

7. Consistent with the above statute, Commission Rule 4 CSR 240-2.180 provides for hearings and stakeholder input on rulemaking.

8. Transactions between a Commission-regulated entity and its affiliates can be neutral, but also potentially present certain moral hazards whereby a regulated utility has the potential to impermissibly benefit from directing the funds from captive ratepayers towards non-regulated operations.

9. The Commission has long understood the vulnerability for consumers when affiliated transactions occur, having investigated Southwestern Bell Telephone Company's affiliated transactions in 1994,¹ considered rules to address affiliated transactions of telephone companies twenty years ago,² and promulgated affiliated transaction rules for electric corporations and gas corporations, nineteen and twenty years ago, respectively.³

10. The Commission has already implemented rules setting forth financial and evidentiary standards, and record keeping requirements for regulated electrical corporations whenever such corporation engages in affiliated transactions as codified in 4 CSR 240-20.015 and 4 CSR 240-20.017.

11. The Commission has also implemented rules setting forth financial and evidentiary standards, and record keeping requirements for regulated gas corporations whenever such corporation engages in affiliated transactions as codified in 4CSR 240-40.015 through 4 CSR 240-40.017.

¹ Case No. TO-94-184.

² Case No. TO-96-328.

³ Case No. EX-99-263; Case No. GX-99-445.

12. The OPC hereby petitions the Commission to open a rulemaking docket and requests a rulemaking workshop to discuss a Water Corporation Affiliate Transactions Rule for water and sewer corporations.

13. The effects on private and public entities is a topic to be explored in the workshop requested in paragraph 12. The financial impacts of any finalized rule shall be determined at the time the rule is formally proposed. As detailed in the attached Memorandum, certain water corporations have been operating under affiliate transaction rule without issue.

PROPOSED RULE

14. Attached hereto as OPC-1 is the full text of the proposed Commission Rule, 4 CSR 240-50.015 that the OPC requests the Commission considers for a rulemaking workshop. The OPC does not seek to amend or rescind any existing Commission rule.

15. In further support of the proposed Commission Rule contained in OPC-1, the OPC hereby tenders its attached Memorandum, along with supporting documents OPC-2 and OPC-3, to the Commission for its consideration.

WHEREFORE, the OPC respectfully requests that the Commission consider the information provided herein, open a rulemaking docket, and conduct a rulemaking workshop to consider a Water Corporation Affiliate Transactions Rule.

Respectfully,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this 22nd day of June, 2018, to the following:

Office of the General Counsel
Governor's Office Building
Jefferson City, MO 65101
staffcounsel@psc.mo.gov

/s/ Caleb Hall
/s/ Ryan Smith

MEMORANDUM

To: Missouri Public Service Commission

From: Geoff Marke, Chief Economist
Missouri Office of the Public Counsel

Subject: Proposed Rulemaking: Water Affiliate Transaction Rules

Date: 22 June 2018

Overview:

The Office of Public Counsel (“OPC”) is requesting the Commission open a rulemaking docket in its Chapter 50 Rules—Water Utilities, for the purpose of adding a subsection titled: “Affiliate Transactions” to be codified as subsection: 4 CSR 240-50.015. OPC has included a draft copy of the proposed rules in attachment OPC-1.

The proposed affiliate transactions rules, when coupled with effective enforcement, will provide the public assurance that their utility rates are not adversely impacted by (i.e., being used to subsidize) the utilities’ affiliate activities. This specific request for rulemaking for Missouri water utilities would not be overly burdensome as the proposed water rules mirror both the electric (4 CSR 240-20.015) and gas (4 CSR 240-40.015) affiliate transactions rules currently in place.

Extent of Application for Proposed Rules:

OPC believes that all water utilities operating in the state of Missouri should be subject to certain rules relating to affiliate transactions including, for example, requirements for competitive bidding, requirements that the utilities maintain control over their own books, rules related to record keeping & access, rules prohibiting preference except under limited circumstances, rules regarding audits, requirements for reporting affiliate transactions, specific definitions regarding cost determination (and other key terms), rules prohibiting the utility from engaging in non-complying affiliate transactions, and a requirement that the utility must pursue its best interest in affiliate transactions. That being said, OPC is cognizant that the level of detail and requisite compliance to meet the proposed rules for a water utility with less than 8,000 customers will need to be balanced against associated costs and burden of proof. While OPC maintains that the proposed rules should apply, at a minimum, to water utilities with more than 8,00 customers, OPC believes that a rulemaking workshop would be appropriate venue to determine the reasonableness of the attached affiliate transactions rules for the remaining water utilities or whether an abridged affiliate transactions rule (with requisite requirements to be included in the minimum filing requirements for the Company’s annual reports to the Commission) would be more appropriate for a water utility with less than 8,000 customers.

Necessity of Proposed Rule:

The necessity of the proposed rules can easily be seen by considering the business practices currently employed by American Water. As articulated most recently in both direct and surrebuttal testimony in Case No. WR-2017-0285, American Water is the only water utility in the United States included in the S&P 500. Headquartered in Voorhees, New Jersey, American Water employs approximately 6,900 people and provides services through its subsidiaries to an estimated 15 million people in 46 states and Ontario, Canada. Among these subsidiaries is Missouri American Water which serves nearly half a million customers with the state.

While Missouri American Water does currently utilize a Cost Allocation Manual ("CAM"), it is not a Commission-approved CAM because there are no affiliate transaction rules in place for water utilities. Missouri American Water's CAM thus lacks any enforceable standards and can only provide minimal protection for the citizens of Missouri when American Water engages in potentially improper subsidization such as its current allocation of Business Transformation System costs to its regulated subsidiaries as opposed to its nonregulated "Market-Based Business" operations. These problems are further exacerbated because the lack of affiliate transaction rules means that regulators must operate at a considerable informational disadvantage in ensuring a transparent and appropriate cost allocation.

Another major area of concern is the interplay between regulated and non-regulated services offered to customers is also a concern. Consider, for example, that American Water's non-regulated affiliate "Homeowner Services" provides services to its subsidiary's customers that include:

- Water and sewer service line protection;
- In-home plumbing emergency program;
- Electric line protection;
- Power surge protection;
- Heating system repair; and
- Cooling system repair

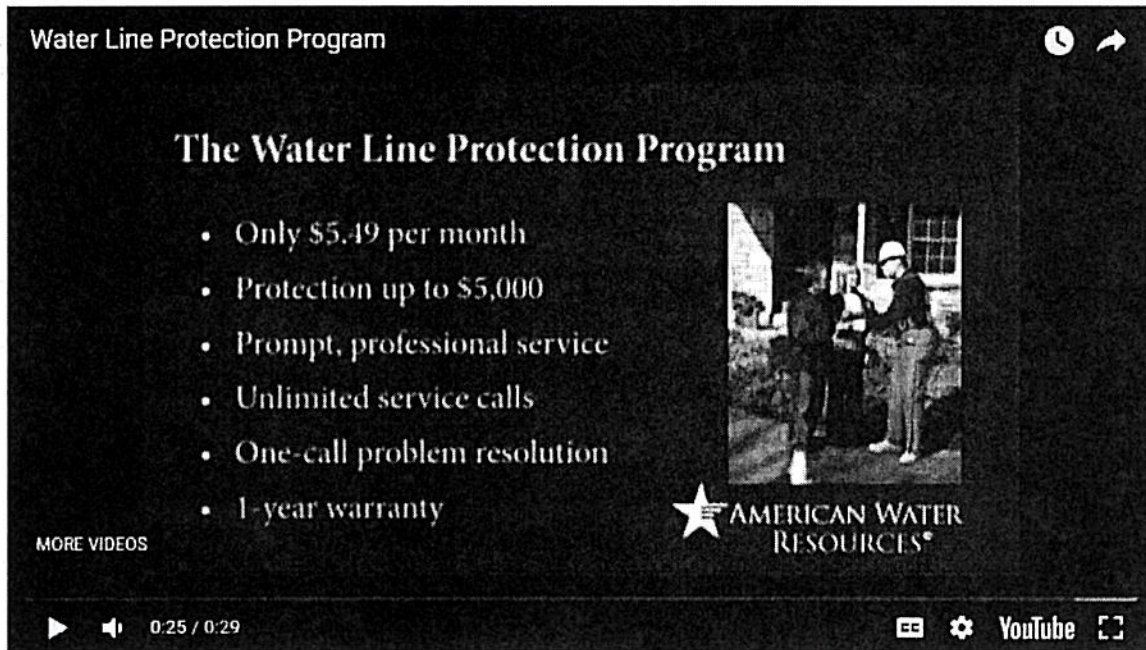
According to the American Water homepage under Industry & Homeowner Solutions:

Homeowner Services>

Many homeowners are not aware that they are legally responsible for the portion of the water and sewer service lines that extend through their property and that repair to these lines are typically not covered by homeowners insurance. For over fourteen years American Water Resources (AWR) has offered water utility services by protecting homeowners, just like you, against unexpected home repair costs. Through our affordable Protection Programs, hundreds of

thousands of homeowners have peace of mind knowing they will receive prompt, courteous, qualified service from a trusted company. AWR helps protect what most homeowners' insurance policies don't, with the claim forms.³ (emphasis added) Figure 1 provides a visual snapshot of the American Water: Water Line Protection Program video currently on its website.¹

Figure 1: Non-regulated water service line protection program²



Beyond being mere speculation, improper allocation of services rendered by American Water subsidiaries has been documented by other states. For example, a New Jersey Public Service Commission ordered independent third-party audit concluded that American Water had implemented an accounting and charging allocation method in which "only seven percent of the work performed can be specifically assigned to New Jersey American Water leaving 93 percent of charges allocated" (see OPC-2).

Finally, the OPC's request for affiliate transactions rulemaking will not be overly burdensome for Missouri American Water as American Water already has subsidiaries operating in other states that have to conform to water utility affiliate transaction rules (see OPC-3).

For all of the aforementioned reasons, OPC makes this long-overdue and reasonable request to the Commission.

¹ American Water Works Company, Inc. (2018) We Keep Life Flowing: <https://amwater.com/corp/>

² American Water Resources (2018) <https://awrusa.com/products-services-water-line-protection>

4 CSR 240-50.015 Affiliate Transactions

(1) Definitions.

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

(B) Affiliate transaction means any transaction for the provision, purchase or sale of any information, asset, product or service, or portion of any product or service, between a regulated water corporation and an affiliated entity, and shall include all transactions carried out between any unregulated business operation of a regulated water corporation and the regulated business operations of a water corporation. An affiliate transaction for the purposes of this rule excludes heating, ventilating and air conditioning (HVAC) services as defined in section 386.754 by the General Assembly of Missouri.

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

(D) Corporate support means joint corporate oversight, governance, support systems and personnel, involving payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, and research and development activities.

(E) Derivatives means a financial instrument, traded on or off an exchange, the price of which is directly dependent upon (i.e., “derived from”) the value of one or more underlying securities, equity indices, debt instruments, commodities, other derivative instruments, or any agreed-upon pricing index or arrangement (e.g., the movement over time of the Consumer Price Index or freight rates). Derivatives involve the trading of rights or obligations based on the underlying product, but do not directly transfer property. They are used to hedge risk or to exchange a floating rate of return for a fixed rate of return.

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

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

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

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

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

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

(2) Standards.

(A) A regulated water corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated water corporation shall be deemed to provide a financial advantage to an affiliated entity if—

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

A. The fair market price; or

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

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

A. The fair market price; or

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

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

(C) Specific customer information shall be made available to affiliated or unaffiliated entities only upon consent of the customer or as otherwise provided by law or commission rules or orders. General or aggregated customer information shall be made available to affiliated or unaffiliated entities upon similar terms and conditions. The regulated water corporation may set reasonable charges for costs incurred in producing customer information. Customer information includes information provided to the regulated utility by affiliated or unaffiliated entities.

(D) The regulated water corporation shall not participate in any affiliated transactions which are not in compliance with this rule, except as otherwise provided in section (10) of this rule.

(E) If a customer requests information from the regulated water corporation about goods or services provided by an affiliated entity, the regulated water corporation may provide information about its affiliate but must inform the customer that regulated services are not tied to the use of an affiliate provider and that other service providers may be available. The regulated water corporation may provide reference to other service providers or to commercial listings, but is not required to do so. The regulated water corporation shall include in its annual Cost Allocation Manual (CAM), the criteria, guidelines and procedures it will follow to be in compliance with this rule.

(F) Marketing materials, information or advertisements by an affiliate entity that share an exact or similar name, logo or trademark of the regulated utility shall clearly display or announce that the affiliate entity is not regulated by the Missouri Public Service Commission.

(3) Evidentiary Standards for Affiliate Transactions.

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

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

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

1. Considered all costs incurred to complete the transaction;
2. Calculated the costs at times relevant to the transaction;
3. Allocated all joint and common costs appropriately; and

4. Adequately determined the fair market price of the information, assets, goods or services.

(D) In transactions involving the purchase of goods or services by the regulated water corporation from an affiliated entity, the regulated water corporation will use a commission-approved CAM which sets forth cost allocation, market valuation and internal cost methods. This CAM can use benchmarking practices that can constitute compliance with the market value requirements of this section if approved by the commission.

(4) Record Keeping Requirements.

(A) A regulated water corporation shall maintain books, accounts and records separate from those of its affiliates.

(B) Each regulated water corporation shall maintain the following information in a mutually agreed-to electronic format (i.e., agreement between the staff, Office of the Public Counsel and the regulated water corporation) regarding affiliate transactions on a calendar year basis and shall provide such information to the commission staff and the Office of the Public Counsel on, or before, March 15 of the succeeding year:

1. A full and complete list of all affiliated entities as defined by this rule;
2. A full and complete list of all goods and services provided to or received from affiliated entities;
3. A full and complete list of all contracts entered with affiliated entities;
4. A full and complete list of all affiliate transactions undertaken with affiliated entities without a written contract together with a brief explanation of why there was no contract;
5. The amount of all affiliate transactions by affiliated entity and account charged; and
6. The basis used (e.g., fair market price, FDC, etc.) to record each type of affiliate transaction.

(C) In addition, each regulated water corporation shall maintain the following information regarding affiliate transactions on a calendar year basis:

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

(5) Records of Affiliated Entities.

(A) Each regulated water corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

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

(6) Access to Records of Affiliated Entities.

(A) To the extent permitted by applicable law and pursuant to established commission discovery procedures, a regulated water corporation shall make available the books and records of its parent and any other affiliated entities when required in the application of this rule.

(B) The commission shall have the authority to—

1. Review, inspect and audit books, accounts and other records kept by a regulated water corporation or affiliated entity for the sole purpose of ensuring compliance with this rule and making findings available to the commission; and

2. Investigate the operations of a regulated water corporation or affiliated entity and their relationship to each other for the sole purpose of ensuring compliance with this rule.

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

(7) Record Retention.

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

(8) Enforcement.

(A) When enforcing these standards, or any order of the commission regarding these standards, the commission may apply any remedy available to the commission.

(9) The regulated water corporation shall train and advise its personnel as to the requirements and provisions of this rule as appropriate to ensure compliance.

(10) Variances.

(A) A variance from the standards in this rule may be obtained by compliance with paragraphs (10)(A)1. or (10)(A)2. The granting of a variance to one regulated water corporation does not constitute a waiver respecting or otherwise affect the required compliance of any other regulated water corporation to comply with the standards. The scope of a variance will be determined based on the facts and circumstances found in support of the application.

1. The regulated water corporation shall request a variance upon written application in accordance with commission procedures set out in 4 CSR 240-2.060(11); or

2. A regulated water corporation may engage in an affiliate transaction not in compliance with the standards set out in subsection (2)(A) of this rule, when to its best knowledge and belief, compliance with the standards would not be in the best interests of its regulated customers and it complies with the procedures required by subparagraphs (10)(A)2.A. and (10)(A)2.B. of this rule—

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

B. Notice of the noncomplying affiliate transaction shall be filed with the secretary of the commission and the Office of the Public Counsel within ten (10) days of the occurrence of the non-complying affiliate transaction. The notice shall provide a detailed explanation of why the affiliate transaction should be exempted from the requirements of subsection (2)(A), and shall provide a detailed explanation of how the affiliate transaction was in the best interests of the regulated customers. Within

thirty (30) days of the notice of the noncomplying affiliate transaction, any party shall have the right to request a hearing regarding the noncomplying affiliate transaction. The commission may grant or deny the request for hearing at that time. If the commission denies a request for hearing, the denial shall not in any way prejudice a party's ability to challenge the affiliate transaction at the time of the annual CAM filing. At the time of the filing of the regulated water corporation's annual CAM filing the regulated water corporation shall provide to the secretary of the commission a listing of all non-complying affiliate transactions which occurred between the period of the last filing and the current filing. Any affiliate transaction submitted pursuant to this section shall remain interim, subject to disallowance, pending final commission determination on whether the noncomplying affiliate transaction resulted in the best interests of the regulated customers.

(11) Nothing contained in this rule and no action by the commission under this rule shall be construed to approve or exempt any activity or arrangement that would violate the antitrust laws of the state of Missouri or of the United States or to limit the rights of any person or entity under those laws.