

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

In the Matter of the Establishment of a)
Working Case for the Review and)
Consideration of Rewriting and Writing of) **Case No. AW-2018-0394**
Existing and New Affiliate Transaction)
Rules and HVAC Affiliate Transaction Rules)

**PUBLIC COUNSEL’S FURTHER RESPONSE TO
STAFF’S DRAFT AFFILIATE TRANSACTIONS RULE AMENDMENTS**

COMES NOW the Office of Public Counsel (Public Counsel) and further responds to the Staff’s September 16, 2019, draft affiliate transactions rule amendments by raising concerns about the extraordinary increase in costs these amendments may engender, and the potential effect of these cost increases on Missouri’s economy.

1. On September 16, 2019, as the Commission directed in its July 17, 2019, *Order Directing Staff to File a Draft Rule*, Staff filed its most recent draft amendments to its June 27, 2019, original suggestions for amending the Commission’s affiliate transactions and HVAC affiliate services rules.

2. Public Counsel appreciates Staff’s explanation of its changes from its June 27 to its July 17 draft amendments in its November 6 *Response to Public Counsel’s Response to Staff’s September 16, 2019, Draft Rules*. Also helpful and necessary, however, at some point in this process, is Staff’s explanation for why the Commission should adopt each of Staff’s most recent amendments to the Commission’s current rules, *i.e.*, Staff’s rationales for each of its presently proposed amendments to the currently effective rules. Both the Commission and Missouri Courts

have found the present rules to be just and reasonable.¹ Any party proposing to amend them should, at a minimum, explain and support each of its proposed amendments to the Commission and other interested parties.

3. Missouri utility companies are expanding their utility operations into other states and into activities directly regulated by the Federal Energy Regulatory Commission. By its proposed amendments, Staff is proposing that this Commission weaken the protections its affiliate transactions rules provide to Missouri consumers from excessive and discriminatory rates. Staff's proposal would increase the opportunities for utility companies to shift unregulated affiliate costs to the rates for regulated customers (cross-subsidization), where recovery is more assured. The Supreme Court related the cross-subsidization concern in 2003 in the following passage from its opinion in *State ex rel. Atmos Energy Corp., et al. v. PSC*, 103 S.W. 3d 753 (Mo. 2003):

[T]he PSC explained that[its affiliate transactions rules] are a reaction to the emergence of a profit-producing scheme among public utilities termed "cross-subsidization," in which utilities abandon their traditional monopoly structure and expand into non-regulated areas. This expansion gives utilities the opportunity and incentive to shift their non-regulated costs to their regulated operations with the effect of unnecessarily increasing the rates charged to the utilities' customers. ("As long as a [public utility] is engaged in both monopoly and competitive activities, it will have the incentive as well as the ability to 'milk' the rate-of-return regulated monopoly affiliate to subsidize its competitive ventures....") To counter this trend, the new rules - and in particular, the asymmetrical pricing standards - prohibit utilities from providing an advantage to their affiliates to the detriment of rate-paying customers.²

4. Below is one of the amendments to the current rules. Staff is proposing to add the following exclusion at Section (2) Standards Subsection (F):

¹ *State ex rel. Atmos Energy Corp., et al. v. PSC*, 103 S.W. 3d 753 (Mo. 2003).

² *Atmos et al.* 103 S.W. 3d 753-4.

(F) This section shall not apply to or prohibit any of the following unless found by the commission, after notice and hearing, that such practice is contrary to the purpose and intent of the Affiliate Transactions Rule:

1. The provision of corporate support services, at FDC, between or among a covered utility and any affiliate, including a service company,

2. The provision, at FDC of goods, information, or services of any kind between or among a covered utility and a rate-regulated affiliate.

5. This amendment would provide significant financial advantages to a regulated utility's affiliate as demonstrated by the following two examples:

Example one: ACME Power and Light (“APL”) requires billing services. APL determines that the cost to perform these services in-house (*i.e.* FDC, the fully distributed cost) would be \$4M. Through competitive bids, APL is aware that there is a third-party non-affiliate willing to provide service at \$3.8M. Under the current version of the rule, APL would only be allowed to pay its non-regulated affiliate \$3.8M for providing billing services—the lesser of the fully distributed cost or fair market price. As Staff proposes to amend the rule, without violating the rule APL could pay its non-regulated affiliate \$4M, **regardless** of the existence of the \$3.8M competitive bid.

Example two: ACME Missouri (“AM”) has in its warehouse certain replacement equipment (spare transformers, poles, etc.). It cost AM \$2M to acquire this equipment; however, due to a rise in steel and aluminum prices, the fair market value of this equipment is now \$3M. AM has a rate-regulated affiliate operating in another state which is doing business under the name ACME Kansas (“AK”). AK experiences a major power failure caused by a large storm. AM sells its stockpile of replacement equipment to AK. Under the current rule, AM would have to sell its stockpile to AK for \$3M, which is the fair market value of the stockpile. As amended as Staff proposes, AM could sell its stockpile to AK for \$2M, which represents AM's fully distributed cost to acquire the stockpile.

6. Due to the critical importance of the asymmetrical pricing standards to prevent a utility from giving its affiliate a financial advantage, the Commission used fully-distributed cost and fair-market value pricing standards in its current rules, explaining:

FDC [fully distributed cost to the utility] assures that all costs are accounted and recovered and FMP [fair market price], in conjunction with FDC, assures that the regulated utilities obtain the best prices or lowest costs possible whether buying or selling or producing goods or services.

Asymmetrical pricing assures that the pricing standard is always applied to the favor of regulated utility's customers. The commenters that objected to FDC and asymmetrical pricing proposed costing methodologies that would not fully account for direct costs, indirect costs and opportunity costs or that would permit transactions to occur at a pricing standard that was not optimized to ratepayers. The alternative proposals would allow cost shifting to occur so long as a direct cost increase did not result for ratepayers. Prices for regulated goods and services would be higher over time than if the affiliate transactions occurred using FMP, FDC and asymmetrical pricing.³

7. This Commission's valid concern for the interests of ratepayers goes to the heart of the need for affiliate transactions rules that are both effective and enforceable. But, the Commission Staff's proposed amendments eliminate the requirement that a utility use fully-distributed cost or fair market pricing when purchasing goods or services from its affiliates or selling goods or services to its affiliate, such as an affiliated services company.

8. Public Counsel's initial request was not to change the rules, but to maintain the current rules and adopt affiliate transactions rules for water corporations.

9. Public Counsel urges caution in proceeding with any amendments to the current rules. Opening these long-standing rules for possible amendments should proceed with the upmost caution because of the Commission's own categorical and resounding support of its current rules when adopted, and strong defense of the rules when challenged to the Supreme Court, indicates the importance of the protections the current rules afford Missouri's residential and business

³ 25 Mo. Reg. p. 56, (Jan. 3, 2000) (emphasis added).

customers – protections against paying higher rates than they would pay if the monopoly electric or gas company paid more than the fair market price for a good or service.⁴

10. In addition to the above issues, presently pending before the Commission are two large electric rate cases – the first was filed in July by Union Electric Co. d/b/a Ameren Missouri, and the second was filed in August by The Empire District Electric Company. Public Counsel’s review to date of these companies and their rate case filings indicates that affiliate transactions will be prominent issues in these cases, and in particular, issues involving the very asymmetrical pricing standards that the Staff’s draft amendments would change. The rate cases will provide the Commission with facts and analysis of the rule as applied to the *actual* test year affiliate transactions of Ameren and Empire, and will help the Commission and all parties better understand the transactions subject to the rule, and how the rule’s asymmetrical pricing standards and reporting requirements continue to be essential in ensuring the rules protect Missouri’s homes and businesses as intended, as the Commission found when it enacted the rules.⁵

WHEREFORE Public Counsel urges the Commission to consider Public Counsel’s recommendations to proceed with caution, avoid making decisions on the proposed rules when the provisions of the current affiliate transactions are before the Commission in contested rate cases, and consider the impact on the Missouri economy of relaxing the current affiliate transactions rules.

⁴ Or conversely, provided a good or service for less than the fully distributed cost to the regulated utility.

⁵ In 1999 the Commission said: “Under the proposed rules, cost shifting and other subsidies are prohibited by application of the pricing standards under section (2) [of the rules]. The standard uses both FDC and fair market price (FMP).” Mo. Reg. p. 55, Vol. 25, (Jan. 3, 2000, Vol.25)

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CERTIFICATE OF SERVICE

I hereby certify that copies of the forgoing have been mailed, emailed, or hand-delivered to all counsel of record this 9th day of December, 2019.

/s/ Lera Shemwell