

Aquila, Inc.  
Policy and Procedure  
Manual  
For  
Affiliate Rules

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# I Introduction

This Policy and Procedure manual for Affiliate Rules was designed to be used for reference and training of Aquila associates. It will be available to all associates on the Intranet via the Regulatory Services website, <http://dept.ucu.com/regulatory/>.

Public utility commissions regulating Aquila will be provided a copy as required.

Updates will be made when necessary and responsibility to maintain this document lies with the Regulatory Services department headed by Maurice Arnall. If you have questions contact Gary Denny at (816) 737-7810.

See Appendix A for a recent structure diagram for Aquila Networks.

## II Standard of Conduct

### A Aquila's Code of Business Conduct

Aquila's standards and practices with respect to affiliate transactions are rooted in the company's Code of Business Conduct (the "Code"). The Code was adopted by resolution of Aquila's Board of Directors and is the defining document that governs how Aquila's associates are required to act in that capacity. The Code is the source for essential guidelines to help associates understand their responsibilities to comply with law and company policy, and to advise management of concerns that the Code or a law has been or may be violated.

Through the Board's Audit Committee, the Board established the Business Conduct Compliance Committee (the "BCCC") and charged it with implementing and supervising the administration of the Code. Associates are required to read, understand, and abide by the policies and directives of the Code. To ensure these requirements are met, Aquila's Human Resources department maintains records confirming that each associate has received a copy of the Code, affirmed his or her understanding of the policies outlined in the Code, and successfully completed a computer assisted, on-line training program regarding the Code's provisions. The Board's authority, through the BCCC, over associate behavior is directly expressed by reference to the Code's discipline provision:

Violation of Aquila's Code of Business Conduct may result in disciplinary action, including but not limited to, warning, suspension or termination of employment. Violations may include non-compliance with Aquila's policies, lack of supervision or diligence in enforcing company policies, providing false or misleading information, as well as any retaliatory actions, direct or indirect, against an associate who reports a reasonably suspected violation of this Code of Business Conduct or other misconduct.

## **B. Affiliate Rules under the Code**

In accordance with the general principles of the Code, Aquila's standards and practices for affiliate transactions are grounded in each associate's individual obligation to follow the Code. Regarding business relations among affiliates, the Code specifically states:

Under Federal Energy Regulatory Commission (the "FERC") and state commission rules, there are rules and statutes limiting transactions between regulated and non-regulated parts of our business (commonly referred to as "affiliate rules"). It is expected that all associates understand and comply with affiliate rules. If you have any questions on the affiliate rule requirements, or conduct necessary to comply with the rules, please contact Gary Denny (816) 737-7810 in the Regulatory Services department.

As more fully explained in the sections that follow, three key concepts captured by this provision of the Code express Aquila's standards and practices in managing compliance with all affiliate rules: (1) management's active role in Aquila's compliance with affiliate rules; (2) the duty of Aquila's associates to understand and comply with the affiliate rules; and (3) the role of Aquila's Regulatory Services department as a resource to other associates and in assessing company-wide compliance.

## **1. Management's Role in Affiliate Rule Compliance**

***Through the Code, Aquila's management acknowledges that there are authoritative rules promulgated by the FERC and various state commissions that govern affiliate transactions in Aquila's regulated operations. Management also recognizes and accepts an obligation to approve, support, and enforce policies, procedures, and practices that enable compliance with affiliate rules.***

Aquila's utility operations are located in federal and multiple state jurisdictions. Consequently, the company is exposed to a variety of affiliate rule regimes. While each set of affiliate rules varies somewhat from the others, each attempts to achieve the same basic results, as expressed by the following excerpt from the opening of Aquila's on-line training module:

Affiliate rules govern transactions between regulated utilities and their non-regulated operations or affiliate entities. The rules are designed to prevent unfair discrimination of non-affiliates and preferences for affiliates. The rules also promote accurate record keeping and reporting. The affiliate rules protect customers by preventing a practice called cross-subsidization.

As a regulated energy company (with myriad compliance obligations) that also has unregulated operations, Aquila simply must, as a practical matter, have policies and procedures in place in order to achieve the general principle of non-cross-subsidization and satisfy the specific requirements of each regulatory agency.

First and foremost among Aquila's policies is the requirement that transactions must be charged directly at fully distributed cost whenever possible. For transactions where this is not possible, a detailed cost allocation process set forth in the company's Cost Allocation Manual ("CAM") is followed, and access to non-financial information is

restricted. Aquila's key procedures with respect to allocating costs include tracking affiliate transactions within the company's accounting system, determining and charging fully distributed costs, developing and maintaining the CAM, auditing these processes, and testing for compliance on an ongoing basis (See section III).

## **2. Associate Duty to Understand and Comply with Affiliate Rules**

***The Code applies to all Aquila associates, from line workers climbing poles in the field to senior managers at corporate headquarters. Each associate must be aware that these affiliate rules exist, and the Code expressly charges each associate with an obligation to comply with all affiliate rules.***

By adopting the Code, Aquila's Board of Directors established a clear policy that all associates are required to comply with the affiliate rules. The biggest managerial challenge, a balancing act of efficiency, is to sufficiently educate associates to achieve compliance without overburdening them with information unrelated to their particular jobs. Aquila's approach to date has been essentially fourfold.

First, Aquila requires that all associates receive training to enable them to recognize affiliate relationships and know whom to contact to report a new affiliate transaction or, if needed, obtain additional information. This is accomplished through the on-line, affiliate rules training module conducted on Aquila's intranet. The purpose of the training module is to provide basic definitions of relevant terms, explain how associates might be affected, and illustrate contexts in which associates might encounter situations covered by the affiliate rules. Examples of real, on-the-job situations are used, and test sections called "Life Lessons" throughout the module ensure that basic concepts are being grasped. Because the training module is on-line, Aquila preserves a record of which associates have successfully completed the module.

Second, a series of group meetings was conducted with the relevant managers and supervisors within the Aquila's operational units to further educate them about issues specifically related to affiliate transactions. Those meetings continue on an ad hoc basis.

Third, specific individuals within the business units that are responsible for a significant number of affiliate transactions received direct training to ensure their understanding of the relevant rules and gain their support for compliance efforts.

Fourth, Aquila has retained regulatory legal counsel in several jurisdictions to provide interpretations of state and federal law or Commission regulations, as required by inside counsel, relevant managers, and other associates.

### **3. The Regulatory Services Department**

***Under the Code the associates of Aquila's Regulatory Services department are Aquila's resource for information relating to Aquila's compliance with affiliate rules. The Regulatory Services department has an express duty to understand affiliate rules in sufficient depth to enable those associates to answer questions from other associates and assess company-wide compliance.***

Because rules governing affiliate transactions are the product of utility regulation, it is natural to locate Aquila's overall, ongoing responsibility for compliance with affiliate rules within its Regulatory Services department. Specifically, the Manager of Regulatory Services – Analytical Support has been given responsibility for managing affiliate transaction policies and procedures for all domestic U.S. jurisdictions in which Aquila operates. Management also has assigned one regulatory analyst to be dedicated full-time to affiliate rules and related matters. Together they handle compliance inquiries, prepare compliance filings, develop and administer compliance testing, provide educational resources, conduct training sessions, obtain legal advice from internal or



external legal counsel related to affiliate transactions, and develop process improvements. From time to time, the Manager and analyst engage Aquila's Risk Assessment & Audit Services staff to review their work, monitor compliance progress, and assist in developing process improvements.

### III Cost Allocation

#### A Fully Distributed Costs

In Aquila's experience, the underlying purpose of all affiliate rules appears to be to prevent, through the direct assignment or equitable allocation of costs, the cross-subsidization of unregulated businesses by regulated businesses.<sup>1</sup> Prevention of cross-subsidization in turn promotes fair competition and a level playing field among affiliates and non-affiliates of the regulated utility. To meet the general intent of affiliate rules across Aquila's operations, Aquila maintains a policy which requires transactions to be charged directly to the business entity receiving benefit whenever possible. Aquila has created a number of business unit, division, and product definitions within its accounting system to allow for the direct charging of costs from one entity to another. A significant side benefit of this system is having the ability to record affiliate transactions for analysis and reporting purposes.

Aquila's system allows an associate performing work outside of his normal job to charge time and any related expenses directly to the affiliated entity receiving the benefit of that associate's efforts. Aquila's accounting system automatically "loads" the direct labor expense with labor related costs such as benefits, insurance, and payroll taxes.

In 2000, Aquila recognized the need to create a more robust, fully distributed costing process. Aquila engaged an outside accounting and consulting firm ("Consultant") to assist in improving Aquila's system

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<sup>1</sup> By way of comparison, Missouri's rule states at the beginning: "PURPOSE: This rule is intended to prevent regulated utilities from subsidizing their nonregulated operations."

by reviewing the current process, evaluating alternatives, and making process enhancement recommendations. A primary objective of the Consultant's study was to prevent cross-subsidization of non-regulated business units by further strengthening the existing process. As a result, additional costs that enable an associate to perform his job were identified and added to the loading process. Specifically, information technology, telecommunication, physical facility, and other support function costs are now being added to direct labor charges between business entities.

## **B Cost Allocation Manual**

Notwithstanding Aquila's improved systems for fully distributing costs, not all transaction costs can be directly charged to the beneficiary business entity. When costs benefit more than one business entity (i.e., "common costs"), a fair and equitable process for allocating such costs must be employed.

Aquila has developed a fair cost allocation process, which is defined, described, and documented in Aquila's Cost Allocation Manual ("CAM"). The CAM was designed to satisfy three primary purposes: (1) provide a consistent method of assigning costs to business units, divisions, and product lines; (2) promote operational efficiencies; and (3) aid management as a tool for cost control. The CAM accomplishes these goals by using cost drivers to assign costs. The term "cost driver" refers to the unit of measure most relevant for allocating a particular cost. For example, Aquila allocates payroll costs incurred by its Accounting department by calculating each business unit's proportionate share of the total number of paychecks produced. The number of paychecks distributed is the cost driver.

Aquila uses a "specific" cost driver when the driver can be directly linked with the cause of the expenses incurred. In all other cases, a "general" cost driver reflecting the business entities involved is applied. These cost drivers are identified in the CAM.

The cost allocation process and the CAM are updated annually or more frequently, if a material change takes place within the organization. It is important to note that the CAM gets presented in each state jurisdiction under varying procedures and is subject to different approval processes

## **C Protected Information**

Generally, “protected information” refers to information obtained by utilities from customers that is not recorded in the accounting system (i.e., information other than that related to revenue and receivables which post to the general ledger).<sup>2</sup> Aquila records protected information in a sub-system of the general ledger called the Customer Information System (“CIS”). It is Aquila’s policy to restrict access to this information by its affiliates. If the protected information is generally available to non-affiliates from other sources, Aquila will make that information available to affiliates and non-affiliates alike at a fair market price.

## **D Other Process Enhancements and Activities**

Aquila’s Legal department and Office of the Corporate Secretary manage the creation and maintenance of the structure of all of Aquila’s corporate entities. By working closely with those departments, the Regulatory Services department has developed a procedure for timely notification of new affiliate relationships as they occur and is able to ensure that complete and accurate knowledge of Aquila’s affiliates is kept up to date. For example, EnergyOne Ventures, LLP, Aquila’s non-regulated natural gas marketing affiliate, was formed, among other reasons, to comply with the electric and natural gas “Marketing Affiliate” rules implemented by the Commission. This entity was later sold as Aquila exited the gas marketing business.

Aquila has also established a procedure through its Accounting department by which the company is able to produce a monthly report

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<sup>2</sup> One state refers to protected information as data obtained by a regulated utility that is not obtainable by non-affiliated entities or can only be obtained at a competitively prohibitive cost in either time or resources.

of all affiliate transactions. For this accounting report, “affiliate transaction” is defined to refer to any transaction recorded on the books where one side of the entry is to a regulated business entity and the other side is to a non-regulated business entity.

Additionally, an informal survey has been conducted of supervisory level associates in Aquila’s Global Networks Group, which comprises, among other things; Aquila’s regulated utility businesses to determine the extent of their involvement in affiliated transactions and to better identify opportunities for future process improvements.

Finally, Aquila’s Human Resource Information System generates a monthly report that tracks the transfer of human capital between business entities.

## IV Definitions

1 Affiliate. Any entity that is *controlled* by a utility.

- As further defined in Missouri regulations: “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 the common control with the regulated (gas, electric or steam) corporation.”

2 Affiliate transaction. The transfer of assets, services or information between the regulated utility and a non-regulated affiliate, including transactions between the regulated utility and its non-regulated utility operations, *not* transactions between two regulated units or two non-regulated units.

- As further defined in Missouri regulations: “any transaction for the provision, purchase or sale of any information, asset, product or service, or portion of any product or service between the regulated... (utility) and an affiliated entity, and shall include all transactions carried out between any unregulated business operation of a regulated ... (utility) and the regulated operations of an... (utility).”

3 Control. An entity can be defined as an affiliate if it is controlled by the utility. Ownership of more than 10 percent of an entity’s voting securities is deemed to be presumptive control. (5 percent in Michigan.)

- As further defined in Missouri regulations: “... possession, directly or indirectly, of the power to direct, or cause the direction of the management or policies of an entity, whether such power is exercised through one or more

intermediary entities, or alone, or in conjunction with, or pursuant to an agreement with, one or more 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 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 rebutting the presumption that its ownership interest in and entity confers control.”

4 Corporate support. Affiliate rules generally provide an exemption from reporting for activities that constitute corporate governance or support.

- As further defined in Missouri regulations: “... means joint corporate oversight, governance, support systems and personnel, involving payroll, shareholder services financial reporting, human resources, associate records, pension management, legal services, and research and development activities.”

5 Fully Distributed Cost. Affiliate rules in each state generally require that transfers of assets or services to affiliates be at that higher of cost or fair market value (FMV). Transfers from an affiliate to the regulated operation must be at the lower of cost or FMV. Currently, when Aquila associates direct charge time to an affiliate for services, only labor and benefit loadings are automatically transferred. Corporate overheads are allocated monthly using drivers that are updated every six months. .

- As further defined in Missouri regulations: “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.”

## V Policies and Procedures

| <b>Policy</b>   | <b>Procedure(s)</b>   |
|---|---|
| Associates are required to read, understand, and abide by the policies and directives of the Code of Business Conduct | 1. Human Resources department maintains records confirming that each associate has received a copy of the Code of Business Conduct, and successfully completed a computer assisted on-line training program   |
| Each associate must comply with the FERC and state commission rules regarding affiliate transactions                  | <ol style="list-style-type: none"> <li>1. All associates must complete an online training process relating to Affiliate rules</li> <li>2. Key associates receive additional periodic training sessions by the Regulatory Services department</li> <li>3. Associates not sure of the rules are instructed to contact the Regulatory Services department</li> <li>4. When non-compliant transactions are discovered or new transactions are contemplated, associates are required to notify Regulatory Services promptly</li> </ol> |
| All transaction must be charged directly at fully distributed cost whenever possible                                  | <ol style="list-style-type: none"> <li>1. Determine and charge fully distributed costs</li> <li>2. Track affiliate transactions for compliance with a monthly report of all affiliate transactions</li> </ol>   |
| When direct charging is not possible the Cost Allocation Manual (CAM) must be followed                                | <ol style="list-style-type: none"> <li>1. Develop and maintain the Cost Allocation Manual (CAM)</li> <li>2. Independent audits may be performed to ensure compliance</li> </ol>   |
| Aquila will obtain a contractual agreement with all affiliated entities   | 1. The Regulatory Services department will maintain a file of all contractual agreements  |



| <b>Policy</b>  | <b>Procedure(s)</b>   |
|--|---|
| All transactions are to be charged directly to the business entity receiving benefit whenever possible | <ol style="list-style-type: none"> <li>1. The Aquila accounting system maintains separate business units, divisions and product definitions to facilitate compliance</li> <li>2. Each transaction is identified by a separate journal ID</li> <li>3. Monthly report of all affiliate transactions reviewed for compliance</li> </ol>  |
| Aquila maintains a fair cost allocation process  | <ol style="list-style-type: none"> <li>1. The cost allocation procedure is described and documented in the cost allocation manual (CAM)</li> <li>2. Asymmetric pricing principles are applied</li> </ol>  |
| Aquila restricts access to protected information   | <ol style="list-style-type: none"> <li>1. Access to protected information is controlled through system access limitations, associate education and definition of job responsibilities</li> </ol>  |
| Aquila will identify and report the transfer of assets and human capital between business entities     | <ol style="list-style-type: none"> <li>1. Property Accounting provides information regarding asset transfers</li> <li>2. Human Resource generates a monthly report to track associate transfers</li> </ol>  |
| Affiliates are not given an advantage over non-affiliates competitors                                  | <ol style="list-style-type: none"> <li>1. Information given to affiliates is made available at the same time to non-affiliates</li> <li>2. Marketing materials, bills and other information that share a logo trademark with the utility must include a disclaimer that the affiliate is not regulated</li> <li>3. Accounting books and records of affiliates are maintained separately from the utility</li> <li>4. Independent audits are performed to ensure compliance</li> </ol> |

## VI Online Affiliate Rule Training Outline

1. Affiliate Rules
2. Aquila Compliance
3. Life Lessons
4. FERC Standards
5. More Life Lessons

### 1 Affiliate Rules

#### What Are Affiliate Rules?

Affiliate rules govern transactions between regulated utilities and their non-regulated operations or affiliate entities. The rules are designed to prevent unfair discrimination of non-affiliates and preferences for affiliates. The rules also promote accurate record keeping and reporting.

The Affiliate Rules protect consumers by preventing a practice called cross-subsidization. A cross-subsidy occurs when the prices (rates) charged to one group of customers are set at a level designed to recover the costs of providing goods or services to a different group of customers.

Different states have different rules for these transactions. Aquila bases its procedures on the Missouri Affiliate Rules (other states, such as CA also have very comprehensive affiliate rules) because all transactions in all states must be filed with Missouri regulators to ensure an appropriate portion of common costs are assigned to Missouri customers. By following the Missouri standard, all Aquila entities can enact consistent procedures that enable compliance with the reporting procedures required by Missouri.

#### What is an Affiliate?

An affiliate is any entity that is controlled by a regulated utility. An entity can be:

- A person
- A corporation, company, or corporate subsidiary
- An incorporated or unincorporated association
- A political subdivision such as a public utility district

Affiliates include entities in which the utility owns a controlling interest or possesses the power to direct management. For purposes of applying Affiliate Rules in Missouri, a non-regulated business or division within the regulated utility is also considered an affiliate.

To see a list of business units, departments and entities that are considered to be affiliates, see appendix B.

## Regulated vs. Non-regulated Operations

Many states regulate gas and electric utilities in order to ensure adequate and reliable supply at fair prices. A regulated utility company generally distributes the energy to the consumer, meters its usage and passes on the supply costs of the energy to the consumer.

Non-regulated operations include such activities as:

- Purchasing and arranging for the delivery of gas to large-volume customers (Competitive Energy, Shipper Services)
- Appliance repair programs (Service One)
- Construction services on customer premises (Tech Services)
- All of the activities of subsidiaries such as Aquila Communication Services

Some states today are examining the issue of regulation and moving toward more competitive markets. Aquila monitors these changing developments and is positioned to take advantage of them should

they occur in states where we do business. However, in states where we operate, the distinction between regulated and non-regulated operations is still very important.

What is an affiliate transaction?

An affiliate transaction is the transfer of assets, products, services, or information between a regulated utility and its non-regulated operations or an affiliate. Examples include contracts for services, shared services, non-financial transactions and exempt transactions.

Aquila processes thousands of affiliate transactions each year in the normal course of business. It's essential that we document these transactions in compliance with regulatory guidelines.

The next section of this training explains in more detail the areas covered by the rules.

## Areas Covered by Affiliate Rules

Affiliate Rules prohibit unfair preferences for affiliates and unfair discrimination against non-affiliates. The rules protect the regulated aspect of our business by preventing Aquila's regulated businesses from subsidizing Aquila's non-regulated businesses.

Aquila has established controls and procedures in order to comply with the Affiliate Rules.

**Pricing controls** – these govern the price recorded for transfers between a regulated company and an affiliate. Asymmetric pricing principles apply. If the utility provides goods or services to the affiliate, the affiliate must pay the greater of fully distributed cost or fair market value. If the affiliate provides goods or services to the utility, the utility must pay the lesser of fully distributed cost or fair market value.

**Record Keeping** – each affiliate transaction should have a journal ID identifying it and assurance that the transaction with all related backup information can be found in the future.

**Reporting** – Aquila must prepare an annual report which includes a list of affiliates and complete information about all transactions with affiliates.

- **Cost Allocation Manual** – this manual defines the cost allocation methods used to allocate common corporate costs that cannot be assigned directly to various business units. This assures that all costs are allocated uniformly and can be accurately tracked and reported.
- **Information to affiliates** – information given to affiliates must be made available at the same time to non-affiliates. For an exchange of information to be subject to Affiliate Rules it must be customer specific or beneficial to a competitive market (i.e. only obtainable at a competitively prohibitive cost in either time or resources). Any customer specific information given must also have prior customer consent.
- **Separation of operations** – books and records of affiliates must be maintained separate from the utility. In some states, certain operations must be completely separated from the utility.

## Consequences of Non-Compliance

There are serious consequences for companies and individuals that do not comply with Affiliate Rules:

- Civil penalties of up to \$2,000 per day can be imposed.
- Criminal penalties including fines up to \$1,000 and up to one year in prison.
- The temporary shut down of company operations resulting in lost revenue to the company and lost pay to associates.

Costs incurred in transactions that do not comply may not be recoverable through the approved regulated rates used to charge retail customers.

## Contracts for services with affiliates

Transactions that involve written contracts with affiliates are the easiest to track. A written contract provides documentation of the terms of the arrangement.

The various states' Affiliate Rules are challenging because they envision record keeping and reporting as if all transactions were written contracts. However, we also need to identify other types of transactions and collect enough information to meet the rule requirements.

## Shared services, costs directly charged

For example, if an Aquila associate performs a non-regulated appliance repair, he/she charges time and materials to the appropriate non-regulated account.

## Shared services, costs allocated

For example, Aquila shares its information technology assets among several affiliates or subsidiaries. We must document the terms of the sharing and the rules for allocating costs among the businesses. Aquila carries the burden of establishing fair market value, distributing the costs according to the cost allocation manual and explaining the transactions.

## Non-financial transactions (no assigned costs) with affiliates

An example is the transfer of regulated associates to non-regulated affiliates. This is allowed in all states, but is still reportable.

### *Exempt transactions (services)*

Corporate support functions such as accounting, human resources, finance, corporate development and legal provide services to Aquila's international and domestic non-regulated operations. Costs can be charged directly or allocated using approved cost allocation manuals, but is exempt from reporting.

## **2 Aquila Compliance**

### Aquila Compliance with the Affiliate Rules

This section explains how Aquila procedures ensure our compliance with Affiliate Rules.

### Unfair Practices

- Affiliate Rules prohibit unfair preferences for affiliates and unfair discrimination against non-affiliates. Each associate with responsibilities in these areas must ensure that their actions comply with Aquila procedures and the Affiliate Rules.

- Do not disclose any information to affiliates that is not made available contemporaneously (at the same time) to non-affiliate competitors.
- Agreements between regulated entities and their affiliates should not be “tied.” In other words, delivery of a product or service cannot be made contingent on purchase of another product or service.
- Do not make sales to affiliates unless we also offer to sell the same product or service to non-affiliates
- Agreements for capacity release to affiliates cannot be tied.
- If we are asked for the name of an affiliate, we can disclose the names of Aquila affiliates. However, we must also provide the names of *known* competitors working on our system.

## Use of Resources

Affiliate Rules do not allow use of Aquila’s regulated businesses to subsidize Aquila’s non-regulated businesses. Each associate with responsibilities in these areas must ensure that their actions comply with Aquila’s procedures and the Affiliate Rules.

- Separate books and records are required for affiliates.
- Marketing materials, bills and other information that share a logo or trademark with a utility must include a disclaimer that the affiliate is not regulated.
- Transactions related to providing corporate governance or support may be exempt from the Affiliate Rules. This includes support provided by departments such as payroll, financial reporting, human resources, or legal services.



## Controls

Controls are required in order to comply with the Affiliate Rules. Each associate with responsibilities in these areas must ensure that their actions comply with Aquila's procedures and the Affiliate Rules. Aquila's procedures include:

- When non-compliant transactions are discovered or new transactions are contemplated, Regulatory Services must be notified promptly.
- Pricing standards are required for all transactions between Affiliates. Cost Allocation Manuals must be used and updated regularly.
- Monitoring – Regulatory Services works with business units and the Accounting department to provide ongoing counsel about these issues. They will maintain a database describing each affiliate transaction, responsible parties, the pricing standard and other required information, and will prepare compliance filings.
- Independent audits will be performed to ensure compliance.
- All associates with responsibilities affected by Affiliate Rules must be trained and remain aware of the importance of compliance.

### 3 Life Lessons

An associate of Aquila provides services for Aquila Communications Services (ACS). What is the appropriate way to charge for the time worked?

- A There is no correct way, as this work is prohibited by Missouri affiliate rules.
- B Time is directly charged to ACS.
- C No reporting is required, as this is not an affiliate transaction.
- D Time is directly charged to Aquila.

In this case, ACS is considered an affiliate and therefore the work is considered an affiliate transaction. Because Aquila (the regulated utility) is providing the service, ACS is charged for the service. The transaction is NOT prohibited in Missouri, although in Minnesota the sharing of associates with affiliates requires prior commission approval.

An Aquila call center is used to support ServiceOne. Which items concerning this transaction are true?

- A The costs can be charged or allocated as Aquila sees fit, as this is not an affiliate transaction.
- B Time is allocated by the call center in accordance with the Cost Allocation Manual.
- C Neither A or B are true.
- D Both A and B are true.

*ServiceOne is a non-regulated operation and therefore the work is considered an affiliate transaction. Because Aquila (the regulated utility) is providing the service, the time is charged in accordance with the Cost Allocation Manual.*

Aquila's Information Technologies (IT) infrastructure and associates are used to support Aquila Networks Canada. How should charges be made and recorded?

- A The costs can be charged as Aquila sees fit, as this is not an affiliate transaction.
- B Costs are allocated to Aquila Networks Canada based on the Cost Allocation Manual and reported in our annual report of affiliate transactions.
- C Costs are allocated to Aquila Networks Canada based on the Cost Allocation Manual but are exempt from reporting.

D Costs are directly charged to Aquila Networks Canada and reported in our annual report of affiliate transactions.

*If Aquila shares its information technology assets among affiliates or subsidiaries, we are responsible for distributing the costs according to the Cost Allocation Manual. In some states IT may be considered exempt corporate support but we are still responsible for tracking the terms of the sharing and following the rules for allocating costs among the businesses.*

Aquila Network Services contracts with PAR Electrical Contractors for construction of transmission and distribution facilities. Under affiliate procedures:

- A This work can be performed without a written contract.
- B This work is strictly prohibited.
- C This work can be done if costs are allocated according to the Cost Allocation Manual.
- D This work can be done if costs are charged directly to Network Services.

*In this case PAR is an affiliate of Aquila, the affiliate procedures apply and a written contract should be obtained. In some states the contract requires pre-approval. The contract price should be charged directly to the entity contracting for goods or services.*

Aquila's accounting, HR, Finance, Corporate Development and Legal departments provide services to Aquila. How should costs be treated and reported?

- A The costs can be charged or allocated as Aquila sees fit, as this is not an affiliate transaction.

B Costs are directly charged to Aquila and reported in our annual report of affiliate transactions.

C Costs are allocated to Aquila based on the Cost Allocation Manual and reported in our annual report of affiliate transactions.

D Costs are allocated to Aquila based on the Cost Allocation Manual but are exempt from reporting.

*Aquila is an affiliate and transactions with Aquila are subject to Affiliate Rules. These Aquila functions are treated as exempt corporate support; therefore we do not need to report the transaction. However, we are responsible for distributing the costs according to the Cost Allocation Manual or charging them directly to Aquila wherever possible.*

Network Operations associates perform HVAC work under the ServiceOne name. How should an associate's time and expenses be charged and reported?

A It doesn't matter; this is not an affiliate transaction.

B Time and expenses are allocated to ServiceOne based on the Cost Allocation Manual.

C These associates should not be working for ServiceOne at all.

D Time and expenses are charged directly to ServiceOne accounts based on the work performed.

*Non-regulated business lines like ServiceOne are not technically affiliates of regulated business lines like Network Operations. However, the Missouri rules require them to be treated as if they were.*

## **4 FERC Standards**

## ***FERC and Affiliate Transactions***

The Federal Energy Regulatory Commission (FERC), created by the Department of Energy in 1977, regulates:

1. Transmission and sale for resale of natural gas in interstate commerce.
2. Transmission of oil by pipeline in interstate commerce.
3. Transmission and wholesale sales of electricity in interstate commerce.

The President appoints the 5 commissioners who are confirmed by the Senate.

FERC has a Code of Conduct that applies to the trading of power. The Code of Conduct was developed to support FERC. Order #888 began the task of creating open access to the nation's transmission grid.

As an organization engaged in the trading of power, gas, coal, and financial products, the FERC code applies to Aquila power operations.

Each associate of Aquila is expected to know, understand the importance of, and obey the FERC Code of Conduct even if they are not directly involved in the trading of power.

Aquila associates are trained on the FERC Code of Conduct in orientation and each associate maintains records of attendance.

The FERC Code of Conduct outlines seven standards for trading organizations.

### **1 Independent Operations**

As applied to our business, this means that associates of Aquila Energy will operate separately from the associates of Aquila, Inc. to the maximum extent possible.

## 2 Confidential Marketing Information

All marketing information shared between Aquila Energy and Aquila, Inc. will be disclosed simultaneously to the public. This simultaneous disclosure is on the OASIS (Open Access/Same Time Information System).

The information covered includes incidental market information, including but not limited to any communication concerning power or transmission businesses, present or future, positive or negative, concrete or potential. Shared associates in a support role are not bound by this provision but they may not serve as an “improper conduit” of information to non-support personnel.

## 3 No pricing favoritism to Aquila, Inc.

Sales of any non-power goods or services by Aquila, Inc. including sales made through its affiliates, Exempt Wholesale Generators (EWGs) or Qualified Facilities (QFs) to Aquila will be at the higher of cost or market price.

## 4 No pricing favoritism to Aquila, Inc.

Sales of any non-power goods or services by Aquila Energy to Aquila, Inc. will not be at a price above market.

Items 3 and 4 address and eliminate any cross subsidy relationship between Aquila Energy and Aquila, Inc.

## 5 Brokering of Power

Aquila Energy will offer Aquila, Inc. power first.

This indicates that Aquila Energy is NOT prevented from brokering Aquila, Inc. power into the marketplace. It may offer this power first, second, or last to a willing buyer.

## 6 Non-exclusive Relationship

The arrangement between Aquila Energy and Aquila, Inc. is non-exclusive. This means that Aquila, Inc. is free to use another power broker, including a competitor, to broker power.

Aquila, Inc. could just as easily have an Enron or a Dynegy, two competitors in the power trading business, broker power owned by Aquila, Inc.

## 7 Brokering Without Fees

Aquila Energy will not accept any fees in conjunction with any brokering services it performs for Aquila, Inc.

### ***FERC Standards – Key Points***

The FERC Code of Conduct creates important proactive barriers between Aquila and regulated utilities such as Aquila, Inc.

The FERC has this to say about communications between affiliates and utilities: “If there is any communication concerning power or transmission business – broker related or not, present or future, positive or negative, concrete or potential, significant or slight - it must be simultaneously communicated to all non-affiliates.”

This separation is broad. It is wide. The words “any” and “all” indicate that FERC is not willing to entertain “exceptions.”

Every associate of Aquila MUST follow the rules in every transaction, in every conversation, every day.

Aquila continues to promote an open, non-discriminatory marketplace for all players. We expect other utilities and affiliates to follow the same rules we do.

Failure to follow the FERC Code of Conduct can result in discipline up to and including termination of employment.

## **5 More Life lessons**

Let's apply what we've covered and your experience to real life situations.

Aquila Corporate purchases a contingent call option, Guaranteed Generation, from Aquila to hedge EBIT. Is this an affiliate transaction?

*This is an affiliate transaction and the FERC Code of Conduct would indicate that the sale of any non-power good or service by Aquila to Aquila, Inc. would not be at a price above market. In this specific case, a FERC filing might be made to demonstrate that the affiliate power transaction is just and reasonable and not unduly discriminatory.*

*It should also be noted that the MO rules define "derivatives," indicating some intent to track these types of transactions.*

Gas/Power Supply purchases options from Aquila to hedge gas, coal and purchased power costs. Is this transaction subject to conditions?

*The activities are considered affiliate transactions – not under the FERC Code of Conduct that directly applies to power transactions, but under the Missouri Affiliate Transaction Rules. According to the Missouri rules, the pricing standard is the greater of FMV or the*



*utility's FDC. In Minnesota, where purchases of gas, power or fuel are considered significant transactions, and require prior commission approval, the transaction might be prohibited.*

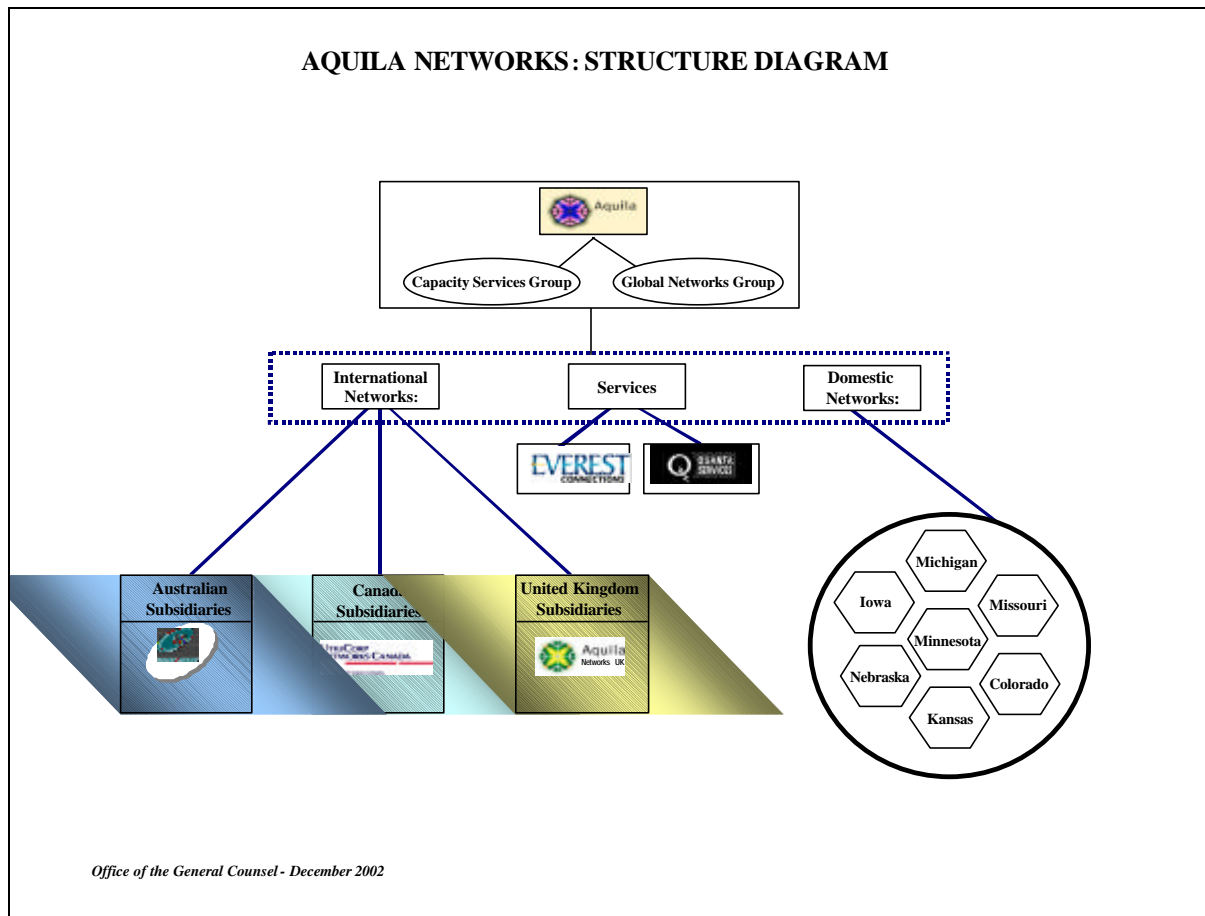
An associate at Aquila received a call from an Aquila, Inc. generation plant manager. The manager asked what the forward price curve might look like. Should the Aquila associate provide the information?

- A Yes. The Aquila, Inc. manager is obviously at a level that is authorized to receive this type of information.
- B The Aquila associate may release the information only if he or she is also a manager.
- C The information may be released as long as the generation plant is not in Missouri.
- D The question cannot be answered under any circumstances.

*This information cannot be released to the Aquila, Inc. generation plant manager by Aquila because it is a clear violation of passing confidential marketing information.*

## VII Appendix

### A Structure diagram



## **B List of Affiliates in the Aquila Accounting system**

| <u>Affiliate Code</u> | <u>Affiliate Name</u>             |
|-----------------------|-----------------------------------|
| AAMM                  | Aquila Asset Mgmt Mississippi     |
| ABHL                  | Aquila Bermuda Holding Ltd        |
| ABS                   | Aquila Broadband Services         |
| ACAM                  | Aquila Capital Asset Mgmt Ltd     |
| ACC                   | Aquila Canada Corp                |
| ACCP                  | Clay County Purchaser             |
| ACCT                  | Aquila Canada Capital & Trade     |
| ACEC                  | Crossroads Energy Center          |
| ACH                   | Aquila Canada Translation         |
| ACHI                  | Aquila Canada Holdings Inc        |
| ACIC                  | Aquila Canada Investment Corp     |
| ACTC                  | Aquila Capital & Trade CND        |
| ACTL                  | Aquila Capital & Trade Ltd        |
| ACTU                  | Aquila Capital & Trade US         |
| ACU                   | Aquila Canada (US\$)              |
| ADE                   | Aquila Dutch Enterprises          |
| ADI                   | Aquila Dock Inc                   |
| AEC                   | Aquila Energy Corporation         |
| AECC                  | Aquila Energy Capital Corp        |
| AECCB                 | AECC Beecher LLC                  |
| AECCG                 | AECC Gas Producers LLC            |
| AECCP                 | AECC Pontiac LLC                  |
| AECSL                 | Aquila Energy Comercializadora    |
| AEEH1                 | Aquila Energy Europe Holdings BV  |
| AEEH2                 | Aquila Energy Europe Holdings BV2 |
| AEFTL                 | Aquila Energy Fin & Trade Ltd     |
| AEGMB                 | Aquila Energy GmbH                |
| AEI                   | Aquila Energy Inc, LLC            |
| AEILL                 | Aquila Energy Intl LLC            |
| AEISL                 | Aquila Energy Iberia SL           |
| AEL                   | Aquila Energy Limited Co1         |
| AELAT                 | Aquila Energy Limited Austria     |
| AELBE                 | Aquila Energy Ltd – Belgian       |
| AELCH                 | Aquila Energy Limited Swiss       |
| AELDE                 | Aquila Energy Ltd – German        |
| AELDK                 | Aquila Energy Limited Denmark     |
| AELFI                 | Aquila Energy Limited Finland     |
| AELFR                 | Aquila Energy Limited France      |
| AELNL                 | Aquila Energy Ltd Netherlands     |
| AELNO                 | Aquila Energy Limited Norway      |
| AELSE                 | Aquila Energy Limited Sweden      |
| AEM                   | Aquila Energy Marketing           |
| AENAS                 | Aquila Energy Nordic AS           |

| <u>Affiliate Code</u> | <u>Affiliate Name</u>          |
|-----------------------|--------------------------------|
| AENB                  | Aquila E - new business        |
| AENBR                 | Aquila Energy Nordic           |
| AEQ                   | Aquila Equipment LLC           |
| AER                   | Aquila Energy Resources        |
| AES                   | Aquila Energy Storage          |
| AESTL                 | Aquila Energy Storage Limited  |
| AESUL                 | Aquila Energy Supplies Limited |
| AET                   | Aquila Energy Transportation   |
| AETL                  | Aquila Energy Trading Limited  |
| AEUKH                 | Aquila Energy UK Holdings Ltd  |
| AEUKI                 | Aquila Energy UK Inc           |
| AEX                   | Aquila Exchange Center         |
| AFLP                  | MEP FLORA POWER, LLC           |
| AGL                   | Aquila Greenwood LLC           |
| AGS                   | Aquila Gas Storage             |
| AIE                   | Aquila Infinite Energy         |
| All                   | Agricultural Investments Inc   |
| AKS                   | Aquila Katy Storage            |
| AL1                   | UtilCo Alabama Generation I    |
| AL2                   | UtilCo Alabama Generation II   |
| ALA                   | Aquila Gas Systems of LA       |
| ALM                   | Aquila Liquid Marketing        |
| ALP                   | UCG Naheola Investment         |
| ALT                   | Aquila Long Term Inc           |
| AOS                   | Aquila Offshore Gas Systems    |
| APC                   | Aquila Power Corporation       |
| APCP                  | Aquila Piatt County Power, LLC |
| AQP                   | Aquila Gas Pipeline            |
| AQP                   | Aquila Gas Pipeline            |
| ARM                   | Aquila Risk Management         |
| ARS                   | Aquila Risk Solutions, Inc     |
| ASI                   | Aquila Services Inc            |
| ATI                   | Aquila Technology Inc          |
| BAF                   | MEP BAF, LLC                   |
| BD                    | Budget Use Only                |
| BHC                   | Bermuda Holding Company        |
| BLH                   | Baker Lake Hydro Inc           |
| BP1                   | Badger Power Generation I      |
| BP2                   | Badger Power Generation II     |
| BPA                   | Badger Power Assoc LP          |
| BRCD                  | Bermuda Canada                 |
| BRE                   | Bermuda Reinsurance            |
| BRM                   | Bermuda Risk Management        |
| BRUK                  | Bermuda UK                     |
| CCG                   | CalCorp Group Inc              |

| <u>Affiliate Code</u> | <u>Affiliate Name</u>             |
|-----------------------|-----------------------------------|
| CEI                   | Cornerstone Energy, Inc Non-UCU   |
| CLEC                  | UCS Competitive Local Exchange    |
| CON                   | Continental Energy Services       |
| ECG                   | Aquila East Coast Generation      |
| EII                   | Energy Investments Inc            |
| ELP                   | Erie Lockport Power Inc           |
| ELUCG                 | Elim UtilCo Group                 |
| ENI                   | Energia Inc                       |
| ENT                   | EnTrust                           |
| EVD                   | Energy One Ventures, LLC          |
| EVE                   | Everest                           |
| EVH                   | EnergyOne Ventures Holding LLC    |
| EXO                   | ExOp – UCS                        |
| EXOP                  | ExOp – 100%                       |
| GBH                   | Golden Bear Hydro Inc             |
| GLA                   | GLA                               |
| GSM                   | Global Securities of Missouri     |
| GSR                   | Global Securities Resources       |
| GWC                   | Guaranteed Weather LLC            |
| HRDPT                 | HR Business Unit                  |
| ISP                   | Internet Service Provider         |
| LEA                   | LEA LP III LLC                    |
| LO1                   | Live Oak Power Generation I       |
| LO2                   | Live Oak Power Generation II      |
| LODI                  | Aquila LODI Storage LP            |
| MCG                   | Mid-Continent Generation Inc      |
| MEP                   | Merch Energy Partners Invest, LLC |
| MEPH                  | Merch Energy Partners Holding     |
| MGC                   | Missouri Gas Company              |
| MGV                   | MG Ventures Storage Inc           |
| MIDAE                 | Aquila Europe, Inc – Midlands     |
| MP1                   | McKittrick Power Generation I     |
| MP2                   | McKittrick Power Generation II    |
| MPA                   | McKittrick Power Assoc LP         |
| MPC                   | Missouri Pipeline Company         |
| MWPDL                 | Marchwood Power Development Ltd   |
| MWPL                  | Marchwood Power Limited           |
| NMV                   | CustomerLink, Inc.                |
| NPL                   | Norland Pipelines Limited         |
| OAS                   | Aquila Oasis Pipeline             |
| OHI                   | Olympia Hydro Inc                 |
| OP1                   | Orlando Power Generation I        |
| OP2                   | Orlando Power Generation II       |
| OPC                   | Omega Pipeline Company            |
| PEQ                   | MEP Pleasant Hill, LLC            |

| <u>Affiliate Code</u> | <u>Affiliate Name</u>             |
|-----------------------|-----------------------------------|
| PHL                   | MEP Pleasant Hill Project Co      |
| PHM                   | MEP Pleasant Hill Marketing LLC   |
| PHO                   | MEP Pleasant Hill Operating       |
| PVN                   | Private Networks                  |
| QUA                   | Quanta Services                   |
| RAD                   | Radius                            |
| ROP                   | Rockfort Power                    |
| RPA                   | Rumford Power Associates Inc      |
| RUM                   | Rumford                           |
| SCP                   | Seward County Pipeline Co         |
| SHI                   | Sierra Hydro Inc                  |
| SJI                   | SJLP – Investments                |
| STI                   | Service Today Inc                 |
| STO                   | Stockton CoGen (II) Inc           |
| TAL                   | Trans Alta                        |
| TMP                   | TransMississippi Pipeline Co      |
| TOP                   | Topsham                           |
| TRN                   | TransUCU                          |
| UAP                   | UtiliCorp Asia Pacific, Inc.      |
| UBC                   | UCU Canada                        |
| UCC                   | UtiliCorp Capital                 |
| UCF                   | UCU Finance Corp                  |
| UCG                   | UtilCo Group Inc                  |
| UCGAS                 | UtiliCorp UK Gas Company          |
| UCH                   | UtiliCorp Holdings Inc            |
| UCL                   | UtilCo Leasing Inc                |
| UCS                   | UtiliCorp Communications Services |
| UCT                   | UCU Capital Trust I               |
| UEC                   | UES – Commercial                  |
| UEL                   | UtiliCorp Energy Limited          |
| UEM                   | UtiliCorp Energy Management       |
| UER                   | UtiliCorp Energy Resources        |
| UES                   | UtiliCorp Energy Solutions        |
| UFL                   | UtiliCorp Finance LTD NZ          |
| UGR                   | UtiliCorp Generation Resources    |
| UKH                   | UtiliCorp UK Holdings I and II    |
| UKI                   | UtiliCorp UK, Inc.                |
| URT                   | UCU Capital Trust II (Rhinos)     |
| USP                   | UtiliCorp South Pacific, Inc.     |
| UTS                   | UtiliCorp Technology Services     |
| WHP                   | WHP Acquisition Co                |
| WHPS                  | Aquila WHP Storage LP             |
| WPV                   | UtiliCorp Comm Services Inc       |
| WVD                   | WVP Energy Delivery               |
| WWD                   | Westwood                          |