

BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

In the Matter of the Application of The Empire District)
Electric Company, The Empire District Gas Company,)
Liberty Utilities (Midstates Natural Gas) Corp., and)
Liberty Utilities (Missouri Water) LLC for an Affiliate)
Transactions Rule Variance.)

Case No. AO-2018-0179

THE OFFICE OF THE PUBLIC COUNSEL’S INITIAL BRIEF

INTRODUCTION

Request

Algonquin Power and Utilities Corp.’s (“APUC”) wholly-owned subsidiaries The Empire District Electric Company (“EDE”), The Empire District Gas Company (“EDG”), Liberty Utilities (Midstates Natural Gas) Corp., and Liberty Utilities (Missouri Water) LLC are seeking Commission relief from the competitive bidding requirements of the Commission’s affiliate transactions rules for purposes of participating in a money pool administered by their parent Liberty Utilities Company (“LUCo”). Based on the evidence in this case, for the reasons the Office of the Public Counsel presented in the evidence, its position statements and in this brief, the Commission must deny them that relief.

Legal Standard

Typically when deciding whether to allow relief from a rule the Commission employs a standard of “good cause”; however, the Commission’s affiliate transactions rules themselves

create an exception for complying with them that follows: “[C]ompliance with the standards would not be in the best interests of [the utility’s] regulated customers.”¹

Neither the Applicants nor the Commission’s Staff identify in their January 24, 2019, Nonunanimous Stipulation and Agreement² how the Applicants have met the standard of “good cause” or “best interests of their regulated customers.” Further, when asked how the standard was met, the Applicants’ and Staff’s witnesses testified that because the Applicants could obtain financing from third parties the standard was met.³

Money Pool

The Commission does not have rules that apply to affiliate transactions by water utilities; therefore, there is no relief for the Commission to give to Liberty Utilities (Missouri Water) LLC, but the Commission has competitive bidding requirements for electric and gas utilities.⁴ Despite these competitive bidding requirements, the Applicants did not competitively bid for money pool services before deciding to participate in a LUCo-administered money pool.

The importance of the Commission’s affiliate transactions rules is emphasized by the Commission’s October 7, 2016, order authorizing the merger of EDE with Liberty Sub Corp. in Case No. EM-2016-0213, where the Commission expressly conditioned its authorization on

¹ See, e.g., 4 CSR 240-20.015(10)(A)2.

² Ex. 3.

³ Ex. 8, OPC witness Schallenberg rebuttal testimony, pp. 4, 12, & 20, Sch. RES-R-5 (January 30, 2019, deposition of Applicants’ witness Timpe), pp. 38-41 (as corrected by Ex. 2, Applicants’ witness Timpe surrebuttal testimony, Sch. MTT-S-1); Ex. 4, Staff witness Bolin direct testimony, pp. 4-5; Ex. 6, Staff witness Murray direct testimony, p. 4; Ex. 8, OPC witness Schallenberg rebuttal testimony, Sch. RES-R-7 (January 29, 2019, deposition of Staff witness Murray), pp. 17, 23-24, and 31.

⁴ 4 CSR 240-20.015 (electric) and 4 CSR 240-40.015 (natural gas).

EDE’s (and others’) compliance with the Commission’s affiliate transactions rules as follows, “The Joint Applicants will not obtain Empire financing services from an affiliate, unless such services comply with Missouri’s Affiliate Transaction Rules.”

Competitive bidding is only one of the requirements of the affiliate transactions rules. The fundamental purpose of the Commission’s affiliate transactions rules is to assure that public utilities subject to them do not engage in transactions with their affiliates on terms that provide an advantage the affiliate that it would not have when dealing with a third party. Part of accomplishing that objective are requirements for creating and providing access to information that demonstrates whether such preferences have happened.⁵ The record in this case does not show that EDE, EDG, or Midstates Natural Gas can create and provide the information required to comply with the Commission’s affiliate transactions rules—show no preference to EDE, EDG, Midstates Natural Gas, or their affiliates—without competitive bidding.

It is the Office of the Public Counsel’s (“OPC”) position that EDE, EDG and Midstates Natural Gas must competitively bid for money pool services before they have the information they need to evaluate whether they should participate in a LUCo-administered money pool. They have not done so, and they have no variance from the requirement that they do so. There are aspects of the LUCo-administered money pool, and the Applicants’ past financial interactions with their affiliates which demonstrate why it would be detrimental for the Commission to give the Applicants relief from the competitive bidding requirements of its affiliate transactions rules.

⁵ See, e.g., 4 CSR 240-20.015(4).

LUCo Money Pool Overview

In the LUCo-administered money pool the participants, based on their net cash on hand, will make daily contributions to or borrowings from the money pool. If the contributions are insufficient to cover the borrowings, LUCo, *at its election*, may infuse cash sufficient to cover the deficiency. LUCo may obtain the cash it infuses from its excess cash, from its line-of-credit, from commercial paper, or from any other source available to it. If LUCo does not infuse sufficient cash to cover the deficiency then money pool participants whose borrowing requests are not satisfied from the money pool will be forced to seek other means by which to satisfy their cash needs.

EDE and EDG already participate in an EDE-administered money pool which long predates when APUC acquired EDE and EDG.

If they join LUCo's utility money pool the Applicants would incur substantial new costs associated with the undrawn credit on LUCo's \$500 million credit facility based on a fixed predetermined allocator of 41% for EDE/EDG and 7.6% for Midstates Natural Gas, respectively. For that reason alone for EDE, EDG, or Midstates Natural Gas to join LUCo's money pool would be detrimental to each of them, and the Commission should deny their variance requests for lack of good cause. To assure they are not creating a preference for LUCo it is essential that EDE, EDG, and Midstates Natural Gas engage in competitive bidding for alternatives before they participate in LUCo's money pool, with its unused credit facility fees and operation costs that they would pay, but over which they would have no control.

The facts in this case demonstrate that LUCo exercises a profit motive in its financial transactions with its regulated subsidiaries such as EDE. LUCo's most significant credit facility

borrowing has nothing to do with its money pools or short-term borrowing needs. LUCo established its \$500 million credit facility on February 23, 2018. EDE's \$90 million in first mortgage bonds matured in June of 2018. EDE refinanced them by executing a 15-year unsecured promissory note with LUCo at an interest rate of 4.53% and paid LUCo \$450,000 as a debt placement fee; a fee which LUCo never incurred. LUCo obtained the funds for that note from its \$500 million credit facility at actual interest rates that have, thus far, ranged from 3.25% to 3.8125%. LUCo is arbitraging the difference between the 15-year promissory note with EDE and LUCo's cost of borrowing on its \$500 million credit facility to its economic benefit.

Annually, based on the difference between 3.8125% (the highest interest rate charged on the loan to date) and 4.53%, EDE is paying to LUCo in excess of \$645,750 in interest expense than LUCo is incurring for borrowing the \$90 million. Over the 15-year life of the loan, the difference would accumulate to over \$9.5 million, unless the spread is reduced in the future. LUCo also charged EDE a \$450,000 placement fee for costs that it never paid to a third party vendor. By these transactions LUCo is obtaining a preference from EDE, a preference that the Commission's affiliate transactions rules are designed to prevent. Competitive bidding would establish whether a third party vendor would offer better terms than LUCo's, terms which include LUCo's recovery of its unused LUCo credit facility costs and allocated money pool operational costs from the participants in its money pools.

Based on this recent past failure to comply with the Commission's rules and order when EDE refinanced its first mortgage bonds, and the terms of the money pool agreement before the Commission, the Commission needs the requirements of its affiliate transactions rules, including their competitive bidding requirements, to ensure the Applicants use non-affiliate investing and

borrowing opportunities when they provide better terms. Thus, the Commission should deny the Applicants' competitive bidding variance requests.

Issues with financial transactions between the Applicants and their affiliates began within the first six months after APUC acquired EDE and its affiliates. Post-acquisition, LUCo directly wholly owns Midstates Natural Gas, and, through Liberty Utilities Central, wholly owns EDE, which directly wholly owns EDG. LUCo, EDE, EDG, and Midstates Natural Gas do not have employees. The employees of Liberty Utilities Service Company ("LUSC"), a wholly-owned direct subsidiary of LUCo manage and operate LUCo, EDE, EDG, and Midstates Natural Gas. In the first half 2017, all of EDE's employees became LUSC employees. The Applicants' witness Mr. Timpe is an employee of LUSC, and it is he who has significant influence over the financial transactions of LUCo and its affiliates, including those between them.

ISSUES

Issue 1. Have The Empire District Electric Company, The Empire District Gas Company, and Liberty Utilities (Midstates Natural Gas) Corp shown good cause for the Commission to grant them variances from the bidding requirements of the Commission's affiliate transactions rules (4 CSR 240-20.015(3)(A) and 4 CSR 240-40.015(3)(A)) for the purpose of them joining and participating in LUCo's money pool with its regulated subsidiaries?

No. Presently EDE and EDG participate in a money pool that EDE operates where borrowing needs that exceed contributions are supported by EDE's capability to issue commercial paper to a limit of \$150 million, which is now backed by LUCo's (Liberty Utilities

Co) \$500 million line-of-credit facility.⁶ No one disputes that commercial paper interest rates are lower than line-of-credit interest rates.⁷ EDE is incurring costs to be able to issue commercial paper; however, it is not incurring any cost to use LUCo's \$500 million line-of-credit to back its commercial paper capability.⁸ This occurred when EDE terminated its \$200 million credit facility. When LUCo acquired EDE, EDE had its own \$200 million line-of-credit facility, but on the day when LUCo could first draw on its current line-of-credit, EDE terminated its line-of-credit facility and, at no cost to EDE, LUCo began to back EDE's commercial paper with its \$500 million line-of-credit.⁹

Applicants' witness Mark Timpe unintentionally reveals the crux of one of the problems with the application. LUCo is being managed to create a money pool in its best interests. Despite representation to the contrary, LUSC is operating LUCo to improve its profitability at the expense of the Applicants. During the hearing Mr. Timpe testified:

[Empire (EDE)'s customers a]re getting a super bargain, and that's something we're trying to correct in this process as well because the customers of

⁶ Ex. 1, Applicants' witness Timpe direct testimony, p. 4; Ex. 2, Applicants' witness Timpe surrebuttal testimony, p.p. 2, & 9; Ex. 5, Staff witness Bolin surrebuttal testimony, pp. 1-3; Ex. 7, Staff witness Murray surrebuttal testimony, p. 3; Ex. 8, OPC witness Schallenberg rebuttal testimony, pp. 4, 12, & 20, Sch. RES-R-5 (January 30, 2019, deposition of Applicants' witness Timpe), p. 23-24, 29-31; Applicants' witness Timpe Tr. 2:28-29, 32-33; Staff witness Murray Tr. 2:121.

⁷ Ex. 1, Applicants' witness Timpe direct testimony, p. 8; Ex. 2, Applicants' witness Timpe surrebuttal testimony, p. 7; Ex. 6, Staff witness Murray direct testimony, p. 2; Ex. 8, OPC witness Schallenberg rebuttal testimony, pp. 4, 13, & 23, Sch. RES-R-7 (January 29, 2019, deposition of Staff witness Murray), p. 26; Sch. RES-R-8 (January 29, 2019, deposition of Staff witness Murray, deposition exhibit 7, Staff witness Murray direct testimony); Applicants' witness Timpe Tr. 2:40, 90-91, 107; Staff witness Murray Tr. 2:119.

⁸ Ex. 2, Applicants' witness Timpe surrebuttal testimony, p. 4, 6; Ex. 8, OPC witness Schallenberg rebuttal testimony, pp. 4, 5, Sch. RES-R-5 (January 30, 2019, deposition of Applicants' witness Timpe), p. 23; Ex. 10 (Applicants' response to OPC DR 1078); Ex. 11 (Applicants' response to OPC DR 1079); Applicants' witness Timpe Tr. 2:33, 71-73 (and Ex. 17), 92-93.

⁹ Ex. 8, OPC witness Schallenberg rebuttal testimony, pp. 4, 5, Sch. RES-R-5 (January 30, 2019, deposition of Applicants' witness Timpe), pp. 23-24; Ex. 10 (Applicants' response to OPC DR 1078); Ex. 11 (Applicants' response to OPC DR 1079); Applicants' witness Timpe Tr. 2:31-33.

the utilities should pay for the availability of credit because if they were on their own, they were a stand-alone business and they went out to the bank market to get a credit facility, they would be paying substantially more because they would not be investment—except for Empire, they would not be investment grade credits. They would not get pricing anywhere near the pricing that's provided by LUCo.

It is that exception for Empire that torpedoes the application. Not only does EDE have an *investment grade credit rating*, it also has a *money pool*, and a *commercial paper program*.

LUCo plans for EDE to pay 41% of LUCo's line-of-credit facility costs related to the unused portion of that facility. It plans for Midstates Natural Gas to pay 7.6%. Unlike the EDE's pre-APUC acquisition credit facility, EDE will be paying the lion's share for a credit facility that it can only access indirectly through LUCo, at LUCo's sole discretion. This shows why the competitive bidding variances should be denied, as the information they would provide is needed for determining whether the Applicants should participate, now and in the future, in a LUCo-administered money pool, or obtain their financial service from an independent third party financial service provider. The proposed LUCo money pool terms are detrimental to EDE, since EDE would start incurring costs for the unused portion of LUCo's \$500 million line-of-credit facility, although EDE is unable to directly borrow against that credit facility. The current information indicates that EDE will be charged over \$200,000 per year for the LUCo credit facility it can access only indirectly at LUCo's discretion. As of the date of the hearing in this case, neither EDE nor EDG has "drawn any short-term borrowings from LUCo."¹⁰ Further, EDE's daily peak short-term borrowings have decreased.¹¹

¹⁰ Applicants' witness Timpe, Tr. 2:30.

¹¹ Ex. 17.

EDE's, EDG's, and Midstates Natural Gas's participation in LUCo's regulated money pool would give LUCo a preference by them paying for their affiliate LUCO's line-of-credit facility asset. If EDE and EDG participate in LUCo's regulated money pool as planned, EDE will eliminate EDE's commercial paper and, therefore, EDE's use of LUCo's \$500 million line-of-credit to back that commercial paper. The Applicants will begin to reimburse LUCo for the costs it incurs to have its \$500 million line-of-credit—either directly by assignment based on borrowings from the money pool that are supported by that line-of-credit, or indirectly by allocation (presently 41%) of the fees LUCo pays to have that line-of-credit based on allocators unrelated to their money pool use. Of LUCo's subsidiaries, EDE will pay the most for LUCo's credit facility, but uses it far less. EDE is also being charged for the internal costs that LUCo and LUSC are incurring to duplicate EDE's money pool.

Without competitive bidding, the Applicants cannot know or be able to avail themselves of cheaper borrowing opportunities than those of participating in LUCo's regulated money pool, *i.e.*, not only the interest rate, but also a share of LUCo's line-of-credit facility commitment fees and costs to operate the money pool. The table following shows the aggregate historical draws to date on LUCo's \$500 million credit facility with to whom the draw benefitted, and LUCo affiliates who supplied funds used to reduce the outstanding balance drawn on LUCo's \$500 million line-of-credit facility.

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This table of actual draws and advances indicates that it is not EDE, EDG or Midstates Natural Gas who will benefit from LUCo's unregulated and regulated money pools. On a standalone basis, the net borrowers are not investment grade borrowers. Therefore, the net borrowers would pay higher interest rates for borrowings than EDE. However, these unregulated affiliates are a significant driver of the magnitude of LUCo's borrowings, and are the real beneficiaries of LUCo's money pools, as is LUCo. With how the Applicants propose to allocate LUCo's line-of-credit facility costs, few, if any, of these affiliates will be charged for those line-of-credit facility costs commensurate with their participation in a LUCo money pool, *i.e.*, these unregulated affiliates are a significant driver for the size and, therefore, availability cost of LUCo's \$500 million line-of-credit.

EDE, EDG, and Midstates Natural Gas are proposing relief from these Commission affiliate transactions rules to participate in LUCo's money pool for its regulated utility subsidiaries where they, based on current factors, would pay \$214,000 (EDE/EDG) and \$39,568 (Midstates Natural Gas), respectively, of LUCo's costs for the undrawn portion of LUCo's \$500 million line-of-credit facility in proportion to four factors. LUCo already is charging EDE/EDG more interest expense than LUCo is actually incurring. Midstates Natural Gas is a net funds contributor so it would pay \$39,568 to contribute (invest) its funds in LUCo's regulated money pool. That a net investor in LUCo's money pool must pay fees for unregulated LUCO's line-of-credit facility costs is detrimental. These fees would offset any interest and investment income that Midstates Natural Gas would receive. Another Applicant money pools-related cost is that LUCo's costs to operate the money pools (section 2.01) are not charged based on participation in a LUCo money pool or recovered from the contributions and advances that fund the money pool. Instead, these costs are to be charged to all of LUCo's subsidiaries, regardless of whether they

participate in a LUCo money pool. Competitive bidding is necessary to determine whether EDE's, EDG's, and Midstates Natural Gas's participation in LUCo's regulated money pool with all of its costs is a better investment opportunity for each of them than using third-party financial services which do not provide a financial advantage to LUCo.

The Applicants have no direct access to LUCo's \$500 million line-of-credit facility. According to the terms of LUCo's applicable money pool agreement, LUCo exercises sole discretion whether to fund the regulated money pool when participants' borrowings would exceed their contributions. LUCo is not restricted on when or for what purpose it can draw on its line-of-credit. One of those purposes may be funding LUCo's separate money pool for its unregulated subsidiaries, a money pool from which LUCo may borrow.

The evidence does not show that the EDE, EDG and Midstates Natural Gas paying LUCo's costs for the undrawn portion of LUCo's \$500 million line-of-credit facility in proportion to four factors would be better than requiring that their transactions with LUCo be at the lower of fully distributed cost or market, as the Commission's applicable affiliate transactions rules require. Further, competitive bidding is necessary, perhaps even more so, to determine whether the Applicants participation in LUCo's money pool with its costs gives them their best investing and borrowing opportunities. While these facts are sufficient for the Commission to determine the Applicants have not shown good cause for relief from the competitive bidding requirements of these rules, for other reasons there is no good cause shown.

Conflicts of Interest

Starting long before LUCo acquired them, EDE and EDG, with Empire District Industries, have participated in a money pool EDE operates. Before LUCo acquired EDE, when

pooled funds were insufficient, EDE financed short-term borrowings that exceeded the pooled money either by drawing on its line-of-credit or by issuing commercial paper at rates lower than those of its line-of-credit. EDE's available line-of-credit was \$200 million, but EDE's commercial paper issuance limit was \$150 million. The Commission order approving APUC's acquisition of EDE includes a condition that when EDE acquires affiliate financial services it must fully comply with the Commission's affiliate transactions rules when doing so. After LUCo acquired EDE, according to the Applicants' witness Mark T. Timpe, LUCo became EDE's sole source of short-term funds; LUCo has a \$500 million line-of-credit. However, EDE has not borrowed any short term funds from LUCo and during the evidentiary hearing Mr. Timpe acknowledged that EDE has access to short-term funds up to \$150 million by issuing commercial paper.¹²

The Applicants' witness Mark T. Timpe is one of EDE's employees who transferred to LUSC in June of 2017. As a LUSC employee, through one or more service contracts, he continues to provide treasury and cash management services to EDE, as well as other LUCo affiliates. This employee transfer between affiliates is significant, and began the process of eliminating EDE's direct control over its cash resources. Subsequently, on February 23, 2018, LUSC employees took a next step toward eliminating EDE's direct control over its cash resources by having EDE terminate its \$200 million line-of-credit facility (which backed EDE's ability to issue up to \$150 million of commercial paper), and LUCo backing EDE's commercial paper with LUCo's \$500 million credit facility at no cost.. This transaction resulted in EDE's money pool now being backed by up to \$150 million in EDE commercial paper which in turn is

¹² Tr. 2:28-29.

backed by LUCo's \$500 million credit facility. Presently, EDE is not paying for LUCo's \$500 million credit facility that backs EDE's money pool, but EDE no longer has access to the at least \$50 million for its non-commercial paper short term (a year or less) cash needs that it had with its \$200 million credit facility. Stated differently, EDE terminated its \$200 million line-of-credit facility in reliance on LUCo backing EDE's money pool and commercial paper with LUCo's \$500 million line-of-credit without LUCo charging EDE to use LUCo's line-of-credit facility to back EDE's commercial paper and money pool.

After LUSC employees terminated EDE's \$200 million line-of-credit, LUCo and its subsidiaries began pursuing the creation of a money pool in which all of its subsidiaries, regulated and unregulated, would participate. In response to regulatory concerns, LUCo created a separate money pool for its nonregulated subsidiaries ("LUCo nonregulated money pool"). LUCo is participating in that money pool as an eligible borrower. Empire District Industries exited EDE's money pool, and now is participating in LUCo's nonregulated money pool. One of LUCo's ultimate goals is to be sole source of cash for its subsidiaries' short- and long-term needs, including the short- and long-term cash needs of EDE and EDG. EDE and EDG had complete control of their cash management needs before APUC (and LUCo) acquired them. If EDE and EDG participate in LUCo's regulated money pool, then it is expected that LUSC employees will terminate EDE's money pool and EDE's ability to issue commercial paper, practically giving LUCo functional control of the management of EDE's and EDG's cash that will be pooled on an extremely limited basis.

Although Section 3.07 of LUCo's money pool agreement notes that the participants ("eligible borrowers") are not "obligated to participate in any transaction contemplated herein if the costs to be charged to such party in connection with such transaction differs from the amount

of the charges they are permitted to incurunder the rules.....of.....any state public utility commission,” it does not prohibit them from doing so. Given that the Applicants have neither employees nor independent financial relationships with non-affiliate financial services vendors, there is a significant risk that the LUSC employees who actually operate LUCo and the Applicants will make decisions primarily based on the benefits to LUCo and its owner, not the benefits to the Applicants, and their customers. This is a preference that the Commission’s affiliate transaction rules are designed to deter.

Mr. Timpe is an officer of LUCo, but not of any of the Applicants. The LUCo regulated money pool is designed to benefit LUCo, not the Applicants. LUCo’s primary motivation for its money pool(s) is to reduce LUCo’s borrowings from its \$500 million line-of-credit facility, showing that the money pool was to support the credit facility, not the reverse. Further, LUCo’s money pool agreement leaves LUCo with great discretion as to the costs and the amounts that LUCo may charge to the participants in its regulated money pool, rather than requiring that the participants’ transactions with LUCo be at the lower of the fully distributed cost to EDE of providing the service to itself, or the market price at which EDE can obtain the same service from an independent third party (e.g., Missouri financial entities). Due to the breadth of LUCo’s discretion in its money pool agreement, the Applicants cannot show good cause for relief from the Commission’s applicable affiliate transaction rules to participate in LUCo’s regulated money pool. Instead, LUCo’s total control appropriately can be checked by competitive bidding, not the elimination of this requirement.

Rules and Order violations

That this LUSC employee conflict is real is borne out by EDE, and one or more of the other Applicants, violation of the Commission's affiliate transactions rules and conditions the Commission imposed in Case No. EM-2016-0213 (where the Commission authorized LUCo to acquire EDE), when they engaged in the foregoing steps to shift away from EDE to LUCo control of the money pool in which EDE participates. Given their noncompliance with Commission rules and Commission-ordered conditions, and a demonstration of how the Applicants and their customers will not benefit from the Commission giving the Applicants the relief they request, the Commission should not give them variances from the Commission's affiliate transactions rules to participate in LUCo's regulated money pool.

Net benefit/detriment unknown

Because it has not been shown by the Applicants or anyone else, it is unknown whether the Applicants, or their customers, will economically benefit by the Applicants participating in LUCo's regulated money pool, since the benefits they will get from lower money pool borrowing rates, and interest and investment income, will be offset by unused credit facility fees and cost to operate the money pool. Actual borrowing activities show that other LUCo subsidiaries will benefit at the expense of the Applicants. Based on the four factors, EDE would be responsible for about 40% of LUCo's costs for the undrawn portion of LUCo's \$500 million line-of-credit facility (approximately \$214,000), and Midstates Natural Gas would be responsible for about 7% (approximately \$40,000) regardless of their money pool borrowing and investment activities. Recall that Midstates Natural Gas is a net contributor, *i.e.*, it produces more excess cash than it needs to borrow. Neither Staff nor the Applicants have specifically identified why it

would be more beneficial to operate LUCo's money pool without complying with the Commission's affiliate transactions rules' competitive bidding requirements. Competitive bidding is essential to provide the Applicants a real opportunity to find and use an independent financial service provider when that provider has better terms. The benchmarking in the Nonunanimous Stipulation and Agreement is woefully inadequate for protecting the Applicants when the data is collected on an untimely basis, giving no opportunity to take advantage of better terms when they are available.

Since the Applicants would have the abilities to borrow or invest outside of LUCo's regulated money pool when available third-party terms are better, competitive bidding is the best way to acquire the information needed to conduct that analysis, and to act on it to take advantage of better terms when they are available. The Applicants have no employees. If they participate in LUCo's regulated money pool then they will have no established relationships with independent financial service providers. Applicants witness Marke Timpe not only will administer LUCo's money pools, he also will be who searches for the Applicants' third-party borrowing and investment opportunities. Mr. Timpe testified that he has not even taken any action to identify the details required for the steps required to satisfy the Illinois rider provisions applicable for Midstates Natural Gas. The Applicants and Staff have provided no evidence that these Illinois rider provisions can be satisfied without competitive bidding.

Tellingly, every other money pool involving a Missouri electric or gas utility operates without anyone having sought or obtained relief from the Commission's affiliate transactions rules' competitive bidding requirements, including EDE. Applicants' witness Mr., Timpe testified that he did not use the provisions of the six (6) existing money pools that he reviewed in

the process of creating the LUCo money agreement. These six pools including Ameren, Berkshire Gas Company, Black Hills Corp., National Grid USA, and Exelon.¹³

If they participate in LUCo's regulated money pool, the Applicants would be charged a predetermined share of LUCo's unused \$500 million line-of-credit facility costs, but LUCo is under no commitment to use that credit facility to support its money pool.

While LUCo has represented that it intends to support its regulated money pool with its investment-grade-rated credit facility, then later with commercial paper, as filed, LUCo's money pool agreement provides for, in Section 1.04, the following funding sources and priorities: First, excess funds from the LUCo utility participants like Midstates Natural Gas (Section 1.04 (a)); second, excess funds in the LUCo treasury to the extent that LUCo in its sole discretion determines to invest such funds in the money pool (Section 1.04 (b)); and third, only when the first two are insufficient, then, at its sole discretion, LUCo may invest proceeds from its credit facility or the sale of commercial paper. Except to guarantee amounts lent from LUCo's money pool, LUCo's money pool agreement does not obligate LUCo to fund its subsidiaries, or the regulated money pool.

There is no good cause to terminate EDE's fully functioning money pool and expose EDE, EDG, and Midstates Natural Gas to ultimately bearing any part of the duplicative costs that LUCo is incurring to develop its money pool functions that EDE's money pool already has. In addition, APUC's affiliates do not use competitive bidding for the goods and services they acquire from each other. If they participate in LUCo's regulated money pool, the Applicants will

¹³ Tr. 2:65.

pay for LUCo's costs to develop its money pools (regulated and unregulated) through their section 2.01 costs (Administrative Costs). Even if they do not participate in a LUCo money pool they will still be charged those costs because LUCo is not separately recording its time spent to develop its money pools. Those money pools duplicate many of the functions that already exist in EDE's money pool.

Issue 2. Do the terms of Section 1.07(b) of LUCo's money pool agreement with its regulated subsidiaries for allocating to the Applicants specific costs of their affiliate LUCo's credit lines that may fund that money pool comply with the Commission's affiliate transactions rules standards which require that "[a] regulated electrical [or gas] corporation shall not provide a financial advantage to an affiliated entity" (4 CSR 240-20.015(2)(A) and 4 CSR 240-40.015(2)(A))?

No. Currently EDE is not paying any costs of LUCo's line-of-credit facility, and it never has paid them, although EDE terminated its \$200 million credit facility and began relying on LUCo's \$500 million credit facility to support EDE's \$150 million commercial paper program. If EDE were to execute LUCo's money pool agreement, EDE would become obligated to pay some of LUCo's line-of-credit facility costs that EDE is not paying now. If they execute LUCo's money pool agreement, Section 1.07(b) would require the Applicants to subsidize LUCo by reimbursing LUCo for LUCo's costs for the undrawn portion of its \$500 million line-of-credit facility when LUCo may use that line-of-credit for any purpose. It would also subsidize LUCo for the costs of that line-of-credit which are not directly assignable to LUCo's regulated money pool or to any of the Applicants other outstanding borrowings. This provision assigns all these costs to the utilities that participate in LUCo's regulated money pool, despite the fact that it is LUCo which has the sole discretion to borrow from or otherwise use that \$500 million line-of-

credit. LUCo has made no commitment that it must use its line-of-credit facility to supply funds to satisfy any money pool deficiency caused by regulated money pool participant loan requests exceeding utility and LUCo excess fund investment pooling. Further, LUCo has not dedicated any portion of that line-of-credit only to support LUCo's regulated money pool.

Section 1.04 (c) specifically states that it is LUCo who has the sole discretion to decide when and whether to use its \$500 million line-of-credit facility to fund LUCo's regulated money pool. LUCo relies on its \$500 million line-of-credit to support activities other than its regulated money pool; activities such as acquisitions, long-term affiliate financings (e.g. to support a long-term loan to EDE), a nonregulated money pool from which LUCo may borrow, and loans to nonregulated LUCo affiliates (e.g. LUSC). Thus, charging of all the indirect costs of LUCo's line-of-credit facility to its regulated money pool participants based on non-cost causative factors provides LUCo with a subsidy and an improper financial advantage. This is the type of transaction that the Commission's affiliate transactions rules were created to prevent. This alone—that the Applicants are to be charged for LUCo's costs to have a line-of-credit available to LUCo that is not dedicated to the Applicants and that LUCo may use, and has used, for purposes other than its regulated money pool—is sufficient to deny Applicants' request for a variance from the competitive bidding requirements of the Commission's affiliate transactions rules.

Issue 3. Are the terms of Sections 2.01 and 2.06 of LUCo's money pool agreement with its regulated subsidiaries sufficiently vague that how LUCo may select the basis(es) for charging costs to operate LUCo's money pool and the method to determine those costs provides a preference to LUCo that does not comply with the Commission's affiliate transactions rules standards which require that "[e]xcept as necessary to provide corporate

support functions, the regulated electrical [or gas] 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 (4 CSR 240-20.015(2)(B) and 4 CSR 240-40.015(2)(B))?

Yes. The LUCo money pool agreement provision that concedes to LUCo sole discretion for defining its money pool operating costs and whether these costs offset money pool interest and investment income, or be charged, in whole or in part, to LUCo's regulated money pool participants or to all of LUCo's utility subsidiaries gives LUCo a preference. Sections 2.01 and 2.06 of LUCo's money pool agreement give LUCo the sole discretion to determine these operating costs, the method used to allocate or assign them to utility participants, and to alter both. There is no indication that the Applicants intend to modify sections 2.01 or 2.06 of the agreement. In an arms-length transaction these terms should be defined for a clear understanding of what these costs are, how they will be determined, when they would be audited, who will bear them, and how they are charged. Also, there is no indication that the Applicants have considered developing the cost information needed for them to comply with the Commission's affiliate transactions rules.

Issue 4. Will any increased interest, investment revenues or decreased borrowing costs to The Empire District Electric Company, The Empire District Gas Company, and Liberty Utilities (Midstates Natural Gas) Corp due to their participation in LUCo's money pool with its regulated subsidiaries benefit their captive retail customers? Will interest, investment revenues be offset by LUCo's money pool expenses?

First question, no. Because they are not included in cost-of-service studies, the Applicants' retail customer rates are not based on the Applicants' short-term investment and

interest income and, thus, are not affected by increases or decreases in them. Since investment and interest income is not considered in setting retail customers' rates, the full impact of this income flows to the utility's net income after income taxes are considered. Thus, any increases in short-term investment or interest income increase the utility's earnings that are available to their parent companies—LUCo, and ultimately, APUC. Unlike short-term investment and interest income, short-term debt does impact utility customer retail rates; however, through EDE's money pool and ability to issue commercial paper, EDE and EDG already have access to low-cost, short-term debt, and OPC knows of no valid reason why Midstates Natural Gas could not participate in EDE's money pool.

EDE and EDG will not decrease their borrowing costs by participating in LUCo's regulated money pool. EDE and EDG presently can borrow through EDE's commercial paper program at lower interest costs than they can obtain through LUCo's line-of-credit facility. Even if LUCo's money pool were supported by a commercial paper program, it would not have a lower interest rate than EDE's commercial paper, which supports EDE's money pool. Supporting LUCo's regulated money pool with commercial paper would benefit net borrowing participants, as borrowing costs based on commercial paper would be less than borrowing costs based on LUCo's line-of-credit. However, net investor participants would not benefit (e.g. Midstates Natural Gas), since investment returns based on commercial paper would be lower than those based on LUCo's line-of-credit. Thus, the apparent economic advantage to one utility applicant of joining LUCo's regulated money pool (net borrower) works to disadvantage another (net contributor (investor)). In other words, LUCo's money pools would benefit all of LUCo's unregulated subsidiaries and some of its utility subsidiaries. The Applicants are not obvious beneficiaries as they will absorb the majority of the LUCo's unused credit facility costs and its

operational costs. Competitive bidding requirements must be maintained to ensure the Applicants opportunities to find and take advantage of better borrowing and investing terms from independent third party financial service providers.

Second question (Will interest, investment revenues be offset by LUCo's money pool expenses?), yes. In addition to the uncertainty of whether participants in LUCo's regulated money pool overall would benefit based on their investment and interest incomes and borrowing rates, there is the issue of all the other costs they would incur as participants. Regardless of whether it participates in LUCo's money pool, EDE is being charged for the costs LUCo is incurring for the redundancy of LUCo creating its money pool and the financial instruments to support it—line-of-credit facility and, potentially, commercial paper program—that EDE already has in place and has been using for years for its money pool and short-term cash needs.¹⁴ But neither EDE, nor any of the other Applicants will have direct access to LUCo's line-of-credit facility or the ability to draw on it at will.

In addition to participants in LUCo's regulated money pool bearing LUCo's costs to create its money pool and for its \$500 million line-of-credit facility, there is Section 1.07(b) of the money pool agreement. That section provides that undrawn line-of-credit facility costs will be allocated to LUCo's regulated money pool participants based on four factors, factors that are unrelated to their borrowing or investing activities. This proposed fee allocation would be inequitable to Midstates Natural Gas, and create a preference for LUCo.

¹⁴ Before APUC acquired it, Midstates Natural Gas had a money pool that Midstates Natural Gas supported with commercial paper.

At present, the four factors would cause the undrawn line-of-credit facility costs to be allocated 41% to Empire and 7.6% to Midstates Natural Gas—these percentages may change over time as the factors and who participates in the pool change. However, LUCo, which has unfettered access to its \$500 million line-of-credit, while LUCo’s regulated money pool participants have only the discretionary, indirect access that LUCo chooses to give them, will pay none of the undrawn line-of-credit facility costs. This is case of regulated utility subsidization of an unregulated parent by paying the costs of maintaining that unregulated parent’s line-of-credit for that parent to use for, not only regulated, but also unregulated purposes.

To further illustrate how inequitable this is, and a subsidy to LUCo, consider the circumstances of Midstates Natural Gas. Historically, Midstates Natural Gas has been a source of cash to LUCo and so would be a net investor in LUCo’s regulated money pool. As a net investor, Midstates Natural Gas’s money pool participation would *increase* the undrawn portion of LUCo’s line-of-credit facility as Midstates Natural Gas’s excess funds will satisfy borrowing requests reducing draws on LUCo’s credit facility, but the line-of-credit commitment fee applies to the *undrawn* portion of LUCo’s line-of-credit. In other words, Midstates Natural Gas would pay *more* of the commitment fee because its’ participation in the money pool *reduces* the amount of its line-of-credit LUCo uses to support its regulated money pool. This is an example of the types of transactions the Commission’s affiliate transactions rules are intended to deter. There is no showing that EDE, EDG, or Midstates Natural Gas, individually or collectively, will benefit overall from participating in LUCo’s money pool, even with the competitive bidding requirements of the Commission’s affiliate transactions rules. Additionally, if EDE, EDG, and

Midstates Natural Gas do not participate in LUCo's regulated money pool, then they will be allocated a portion of LUCo's costs to operate its money pool.¹⁵

Further, LUCo may draw on its line-of-credit for unregulated purposes. Those purposes may include (1) supporting LUCo's non-regulated money pool (in which LUCo participates), (2) supporting other activities of LUCo and its non-regulated subsidiaries (e.g. LUCo acquisitions), and (3) supporting long-term financing of affiliates at a profit (e.g., LUCo's refinancing of Empire's \$90 million of first mortgage bonds with a fifteen (15) year note payable to LUCo at 4.53%). Section 1.07 (b) does not address from whom LUCo's credit facility commitment fees are to be recovered, other than from participants in LUCo's money pool, is the type of transaction the Commission's affiliate transactions rules are intended to deter.

Issue 5. Have The Empire District Electric Company, The Empire District Gas Company, Liberty Utilities (Midstates Natural Gas) Corp, and Liberty Utilities (Missouri Water) LLC complied with the Commission's rules and orders since they became subsidiaries of Algonquin Power & Utilities Corp.?

No. The Applicants have not exercised effective enforcement of the Commission's affiliate transaction rules 4 CSR 240-20.015 and 4 CSR 240-40.015. The entirety of the Applicants' workforce is employees of their affiliate LUSC. Terminating EDE's \$200 million line-of-credit facility and starting to use LUCo's \$500 million line-of-credit facility without first seeking competitive bids to consider non-affiliate options is contrary to the competitive bidding requirements of the Commission's affiliate transactions rules.

¹⁵ LUCo money pool agreement Section 2.01 costs.

Not complying with the Commission's affiliate transactions rules is illustrated by the actions of the LUSC employee(s) who was/were acting for EDE when he/they retired EDE's \$90 million of first mortgage bonds in 2018 and refinanced them with LUCo long-term debt, debt that LUCo supported with its \$500 million line-of-credit facility. This/these LUSC employee(s) did not seek competitive bids for short- or long-term refinancing of EDE's \$90 million of first mortgage bonds. Instead he/they created circumstances where, although EDE had access to commercial paper rates, LUCo, at least initially, is reaping the difference between the 4.53% interest rate on a 15-year note with EDE and LUCo's interest rate on its \$500 million line-of-credit facility. LUSC employee(s) did so despite EDE's access to commercial paper at rates below LUCo's \$500 million line-of-credit rate, and without soliciting or obtaining any competitive bids for either long- or short-term refinancing the \$90 million of first mortgage bonds, and without evaluating whether EDE was better off if it refinanced the bonds with short- or long-term debt, secured or unsecured.

By having EDE provide this financial advantage to LUCo in 2018, one or more LUSC employees also violated one of the Commission's conditions for approving LUCo's acquisition of EDE. This is important because EDE's and LUCo's failures to comply with (1) these ordered conditions and (2) the Commission's affiliate transactions rules indicate that it is unlikely they will comply with their commitments in their Nonunanimous Stipulation and Agreement with Staff.

Issue 6. Does LUCo's money pool agreement with its regulated subsidiaries address the Applicants' record-keeping requirements and access to LUCo's books and records for the Commission to ensure compliance with the Commission's affiliate transactions rules as expressed in rules 4 CSR 240-20.015(5)&(6) and 4 CSR 240-40.015(5)&(6)?

No. The Commission's affiliate transactions rules require the Applicants to keep books of accounts and supporting records with sufficient detail to permit verification of their compliance with the rules. The Applicants also must keep their books, accounts, and records separate from those of their affiliates. Without their own employees, these requirements must be met by the employees of the Applicants' non-regulated affiliate, LUSC, acting on the Applicants' behalfs. There is little documentation available to verify that key decisions made by LUSC employees for the Applicants complied with the Commission affiliate transactions rules. Decisions such as the following have inadequate documentation:

1. The decision to transfer EDE's treasury department personnel to LUSC, a non-regulated affiliate, which is undocumented;
2. The decision to terminate EDE's credit facility and rely on LUCo's new credit facility for EDE's commercial paper support at no cost to EDE and without documentation regarding the terms and conditions between LUCo and EDE for doing so;
3. The decision for EDE to execute a LUCo long-term note that LUCo funded with cheaper short-term debt and charging EDE at a rate above the rate at which EDE could refinance on its own, which is undocumented;
4. The decision to refinance EDE's first mortgage bonds without competitive bidding;
5. The decision to rely on LUCo's credit facility to support LUCo's long-term note instead of issuing EDE's commercial paper when refinancing first mortgage bonds, which is undocumented;
6. The decision not to enforce the "actual costs" provision in EDE's services agreement with LUSC, which is undocumented; and

7. The decisions regarding the accounting, development, and EDE and EDG payment for a redundant money pool operated by LUCo. Further, there are no approvals by the boards or officers of any of EDE, EDG or Midstates Natural Gas to support that, as to these decisions, they have complied with the Commission's affiliate transactions rules.

EDE has refused to insist that to EDE the fair market value of LUCo developing and implementing a money pool with features EDE already had incurred and paid for when it developed and implemented its existing money pool is zero. The Applicants have provided little or no documentation supporting general compliance with the Commission's affiliate transactions rules, or for compliance of the specific items identified above.

Issue 7. Is The Empire District Electric Company complying with the following conditions the Commission imposed on it in Case No. EM-2016-0213:

- a. Empire will not obtain financing services from an affiliate unless such services comply with Missouri's Affiliate Transaction Rules 4 CSR 240-20.015 and 4 CSR 240-40.015;
- b. "Empire shall maintain corporate officers who have a fiduciary duty to Empire"; and
- c. "Empire shall maintain its own board of directors with a majority of non-management independent directors?"

No. There are three pre-acquisition EDE financing services that EDE affiliates are now performing. The first is EDE's replacement of its credit facility with LUCo's credit facility. The second is EDE's redemption of its \$90 million of first mortgage bonds by LUCo financings. The third is the transfer of all EDE employees to LUSC, a non-regulated affiliate, who now provides

the personnel who effectively make all of EDE's decisions, including those related to financings and financial activities such as creation of and participation in money pools. EDE took all of these actions without using competitive bidding for the services, or obtaining the authorizations or approvals of its officers and board.

Conclusion

Based on all of the foregoing, the Commission should deny the Applicants' request for a variance from the competitive bidding requirements of the Commission's affiliate transactions rules.

Respectfully,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 18th day of July 2019.

/s/ Nathan Williams