

MEMORANDUM

To: Public Service Commission of the State of Missouri
From: John Clizer, Senior Counsel, Office of the Public Counsel
Subject: Proposed Improvements to the Commission’s Proposed Affiliate Transactions Rule, 20 CSR 4240-10.155(2)(F)
Date: December 6, 2024

I. Introduction

If implemented as currently proposed, the provision found in subsection (2)(F) of the Commission’s Proposed Affiliate Transactions Rule (the “Proposed Rule” or “Rule”) will allow utility companies to subsidize their affiliate operations by either (1) paying an affiliate more than the fair market price for goods, information, or services provided by the affiliate or (2) by providing an affiliate with goods, information, or services below the fair market price for those items. This will likely result in the Proposed Rule unnecessarily raising costs to customers and allowing utilities to provide their affiliates with a clear financial advantage over non-affiliate competitors. Such an outcome directly contradicts the purpose of the Affiliate Transaction Rule and would codify a presumption of prudence in favor of a utility’s affiliates in contravention of the Missouri Supreme Court’s mandate.

To best understand the problem, one should break it down into two parts. The first part is to seek to understand what a financial advantage is under the Proposed Rule and why the Rule seeks to prevent a utility from giving its affiliate a financial advantage. The second part requires understanding how provision (2)(F) of the Proposed Rule will allow utilities an opportunity to provide their affiliates a financial advantage despite the conclusions drawn in part one. With these understandings, the OPC proposes a solution that seeks to maintain the integrity of the Rule’s prohibition against providing affiliates with a financial advantage, while maintaining the language regarding the provision of corporate support services—simply append section (2)(F) of the Proposed Rule to the end of section (2)(B).

II. Understanding a Financial Advantage as Defined by the Proposed Affiliate Transactions Rule

A. The Proposed Rule’s Language

The stated purpose of the Proposed Rule is to prevent utilities from subsidizing their affiliate's¹ operations. The Rule seeks to effectuate this goal by, in part, banning a utility from providing a “financial advantage” to an affiliate under section (2)(A).² The term “financial advantage” is defined under provision (1)(I);

(1)(I) Financial advantage means an advantage provided by a covered utility to an affiliate when the covered utility:

1. Compensates an affiliate for assets, goods, information, or services of any kind above the lesser of
 - A. The fair market price (FMP)^[3]; or
 - B. The fully distributed cost (FDC)^[4] to the covered utility to provide the assets, goods, information, or services for itself; or
2. Transfers assets, goods, information, or services of any kind to an affiliate below the greater of
 - A. The FMP; or
 - B. The FDC to the covered utility.

This definition outlines two scenarios where a financial advantage can be supplied by a utility to an affiliate. First, when the utility is buying from its affiliate, a financial advantage is created when the price paid is above what it would be in the competitive market (the “fair market price”) or what it would cost the utility to produce whatever is being bought for itself (the utility’s “fully distributed cost”). Second, in the inverse, a financial advantage is created when a utility is selling to its affiliate

¹ The Proposed Rule in § (1)(A) defines an affiliate to be:

[A]ny person, including an individual, corporation, service company, corporate subsidiary, firm, partnership, incorporated or unincorporated association, political subdivision including a public utility district, city, town, county, or a combination of political subdivisions, which directly or indirectly, through one (1) or more intermediaries, controls, is controlled by, or is under common control with the covered utility. This term shall also include the nonregulated business operations of a covered utility.

² Section (2)(A) states; “A covered utility shall not provide a financial advantage to an affiliate.”

³ The Proposed Rule defines FMP, in part, as “a price determined by a covered utility as the amount it would pay or receive for receiving or providing a good or service in an affiliate transaction based on comparisons of similar transactions with, or the price of similar goods and services available from, unrelated third parties.”

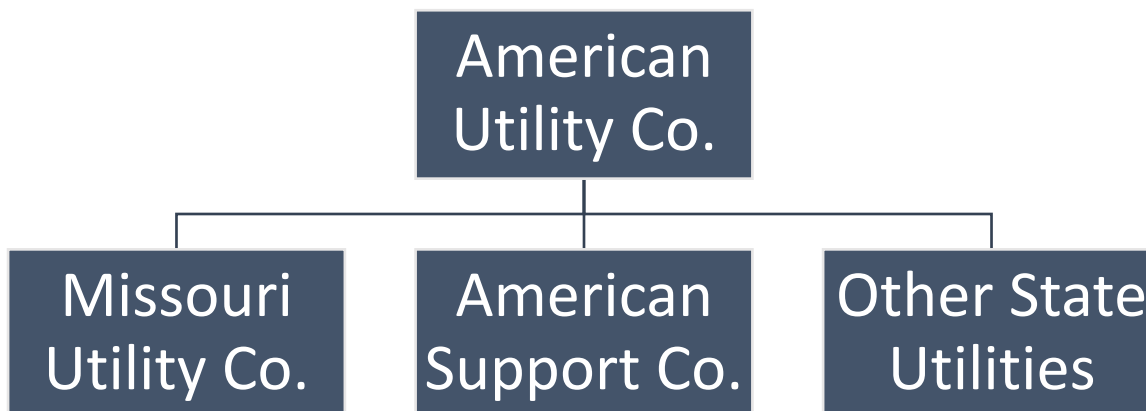
⁴ The Proposed Rule defines FDC, in part, as “a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. FDC requires recognition of all costs incurred directly or indirectly to produce a good or service.”

if the price is below either the competitive market or its own internal cost. To illustrate, consider an example.

B. Illustrative Example: *Missouri Utility Co.*

a. Corporate Structure of *Missouri Utility Co.*

Assume a utility company simply named *Missouri Utility Co.* is a wholly owned subsidiary of a parent company named *American Utility Co.* This parent company also owns several other utilities that operate in other states, but that is irrelevant to this discussion. What is relevant, however, is the fact that *American Utility Co.* wholly owns a support services company named *American Support Co.* that provides support services to all the utilities owned by *American Utility Co.* including, of course, *Missouri Utility Co.* A simplified version of the corporate structure just described can be seen in the figure below:



Under these circumstances, *Missouri Utility Co.* would be an affiliate of *American Utility Co.* because it is a wholly owned subsidiary and is therefore controlled by *American Utility Co.* In addition, *Missouri Utility Co.* would also be an affiliate of *American Support Co.* because they are under “common control” of *American Utility Co.* Having established the framework, we now consider a possible transaction.

b. Transaction: *Missouri Utility Co.* Seeks Accounting Services

Assume that *Missouri Utility Co.* is seeking to procure accounting services related to the management of its books and records and the completion of an internal audit. In this sense, *Missouri Utility Co.* has at least three easily identifiable options. First, *Missouri Utility Co.* could hire auditing staff who would work directly for *Missouri Utility Co.* to complete the work required. Second, *Missouri Utility Co.* could contract with *American Support Co.* to have the work performed by the shared support staff. Third, *Missouri Utility Co.* could take the procurement of

accounting services to market and seek to hire an outside accounting firm. Let us assume that *Missouri Utility Co.* properly considered all three approaches. It does this by soliciting bids for accounting services from both its affiliate *American Support Co.* and an unaffiliated third-party accounting firm named *Generic Accountants, Inc.*, in addition to investigating how much it would cost to increase its internal accounting staff. The relative price comparisons for the three options are as follows:

Option	Total Cost of Option
Option 1: <i>Missouri Utility Co.</i> increases its internal auditing staff to perform the auditing work	\$1,000,000
Option 2: <i>Missouri Utility Co.</i> contracts with <i>American Support Co.</i> to do the auditing work	\$500,000
Option 3: <i>Missouri Utility Co.</i> contracts with <i>Generic Accountants, Inc.</i> to do the auditing work	\$400,000

In this case, the “fully distributed cost” or FDC for *Missouri Utility Co.* to perform the accounting services for itself is \$1,000,000 because this is what it would cost for *Missouri Utility Co.* to hire the personnel needed to do the auditing work for itself.

The “fair market price” or FMP for the auditing work, meanwhile, would be \$400,000 because this is what it would cost to procure those auditing services from the only “unrelated third party” to the transaction (*Generic Accountants, Inc.*).

c. Application of the Proposed Rule: The Rule Should Prevent *Missouri Utility Co.* from Subsidizing its Affiliate, *American Support Co.*

Because *Missouri Utility Co.* is procuring services, only the first part of the two-part definition of financial advantage applies. Again, this definition in broad terms states that a financial advantage occurs when a covered utility compensates an affiliate for services above the lesser of FMP or FDC. Thus, to avoid providing a financial advantage to its affiliate (*American Support Co.*), *Missouri Utility Co.* could only compensate *American Support Co.* at or below the lesser of the FMP (\$400,000) or the FDC (\$1,000,000).

If *Missouri Utility Co.* decided to contract with *American Support Co.* at the \$500,000 price stated in the table above, then it would not be below the lesser the FMP or FDC and would therefore

be providing *American Support Co.* a financial advantage, as defined by the Proposed Rule. Specifically, it would mean *American Support Co.* was able to charge \$100,000 more for accounting services than it would otherwise be able to charge in a truly competitive market. That \$100,000 would likely be passed directly onto *Missouri Utility Co.*'s customers, and it would also enrich the shareholders of *American Utility Co.* who own and control both *Missouri Utility Co.* and *American Support Co.* This is why *American Utility Co.* has a clear incentive to force *Missouri Utility Co.* to spend the additional money to contract with its own affiliate—*American Support Co.*—despite the lack of benefits to *Missouri Utility Co.* or its customers. In doing so, *American Utility Co.* would effectively be using *Missouri Utility Co.* to subsidize *American Support Co.* – and by extension its own – operations. This is precisely what the Affiliate Transactions Rule was designed to avoid.⁵

Having a utility pay more than is necessary to an affiliate – and thereby convey a financial advantage to that affiliate – benefits the owners of the utility (*Ameren Utility Co.*) because they are, by definition, the same owners of the affiliate (*American Support Co.*). However, there is no corresponding benefit to the utility's (*Missouri Utility Co.*) ratepayers in such a transaction—they will simply bear the higher costs. That is why provision (2)(A) of the Rule specifically prohibits a utility from providing a financial advantage to its affiliate. Section (2)(A) is designed to prevent this form of cross-corporation subsidization, per the stated purpose of the Rule. Yet, the Proposed Rule's provision (2)(F) eliminates this protection, as explained below.

III. If Implemented as Proposed, Section (2)(F) Will Eliminate the Prohibition Against Utilities' Providing a Financial Advantage to Their Affiliates for the Provision of Corporate Support Services

If implemented as proposed, section (2)(F) will eliminate the protections built into the Affiliate Transaction Rule – chiefly those found in section (2)(A) – under certain circumstances. To show how it does so, let's start with the language of section (2)(F) and then return to our example utility, *Missouri Utility Co.*

A. Language of Proposed Section (2)(F)

Section (2)(F) states:

⁵ The first sentence of the purpose statement included in the Proposed Rule reads: "This rule is intended to prevent a Missouri Public Service Commission regulated electrical corporation, gas corporation, heating company, water corporation (with more than eight thousand (8,000) customers) or sewer corporation (with more than eight thousand (8,000) customers) from subsidizing its nonregulated operations."

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

1. The joint provision of corporate support services, at FDC, between or among a covered utility and any affiliate. This includes joint provision of corporate support services by an affiliated service company; and
2. The provision, at FDC, of goods, information, or services of any kind between or among a covered utility and an affiliate regulated by the commission or other state utility commission.

The effect of this language in simple terms is the removal of the need to show that goods, information, or services are being bought at or below the fair market price for those goods, information, or services (or that goods, information, or services are being sold at or above the fair market price for those goods, information, or services) so long as the utility is buying or selling from either (1) a corporate support services company or (2) another regulated affiliate. Instead of considering the issue of the fair market price, a utility doing business with one of these two entities only needs to establish that the goods, information, or services are being bought or sold at fully distributed cost.⁶ To see why this is a problem let's return to the example transaction discussed above.

B. Illustrative Example: Proposed Section (2)(F) Would Allow *Missouri Utility Co.* to Provide a Financial Advantage to its Affiliate, *American Support Co.*

In the example transaction, *American Support Co.* offered to provide *Missouri Utility Co.* “corporate support services” in the form of accounting services at the FDC of *American Support Co.* (\$500,000). Because *American Support Co.* is an affiliated service company of *Missouri Utility Co.*, subsection 1 of section (2)(F) would apply. Because subsection 1 of section (2)(F) applies and *American Support Co.* is offering to provide *Missouri Utility Co.* “corporate support services,” the requirements of section (2)(F)1 are met and, as a result, the entirety of section (2) of the Rule no longer applies. This would include subsection (2)(A), which prohibits a covered utility from providing a financial advantage to an affiliate. As a result, *Missouri Utility Co.* can now enter into

⁶ There is a degree of ambiguity in this language concerning whether that is the fully distributed cost of the utility or the fully distributed cost of the affiliate entity. For the purpose of this discussion, the OPC assumes that the Rule intends to require the goods, information, or services are being bought or sold at the fully distributed cost of the affiliate. However, it would be extremely wise if nothing else for the Commission to clarify this point should it choose to ignore the remainder of the concerns raised regarding section (2)(F).

a contract with *American Support Co.* to provide the services for \$500,000 despite the availability of a \$400,000 alternative offer from a non-affiliate entity. As explained above, this benefits the shareholders of *American Utility Co.* and harms *Missouri Utility Co.*'s ratepayers.

C. The Language Providing for a Commission Finding Does Not Fix the Problems Associated with Section (2)(F)

It is possible that someone reading this Proposed Rule would see the language that reads “unless found by the commission, after notice and a hearing, that such practice is contrary to the purposes and intent of the Affiliate Transaction Rule” and believe that language is a cure to the above problem. But this language does not resolve the problem. To illustrate, consider the following:

1. Under both subpart 1 and subpart 2 of the proposed (2)(F), whatever good or service is being procured must be “at FDC.”
2. Because the goods or services are “at FDC” they will never be above or below FDC. This means that one half of the definition of financial advantage found in (1)(I) will always be satisfied, regardless of whether goods, information, or services are being bought or sold by the utility.⁷
3. Therefore, in every situation where a utility procures goods, information, or services from either an affiliate support services company or another regulated entity “at FDC,” the only remaining issue to determine when deciding if the standard in (2)(A) has been satisfied is whether the goods, information, or services are being procured “at or below” the fair market price for those goods, information, or services.⁸
4. In making that determination, there are only two possibilities that can occur. Either:
 - a. the goods, information, or services are being procured at or below the FMP; or
 - b. the goods, information, or services are not being procured at or below the FMP.

Now, step back and consider the two possibilities under step 4. In situation (a), a utility has procured goods, information, or services at FDC and at or below FMP from its affiliate. Therefore,

⁷ A utility cannot compensate an affiliate for good, information, or services above the FDC if the transaction is at the FDC nor can it transfer goods, information, or services below the FDC if the transaction occurs at the FDC.

⁸ In the inverse, in every situation where a utility transfers goods, information, or services from either an affiliate support services company or another regulated entity “at FDC,” the only remaining issue to determine when deciding if the standard in (2)(A) has been satisfied is whether the goods, information, or services are being transferred “at or above” the fair market price for those goods, information, or services.

the utility has necessarily not compensated the affiliate above the lesser of FDC and FMP. This means that a financial advantage, as defined in section (1)(F), has not been provided. Under this scenario, the requirements of section (2) of the Rule are already met. In this situation, section (2)(F) does effectively nothing because the transaction is already in compliance with the section. Now let us consider the opposite situation.

Under scenario (b), the utility has procured goods, information, or services from its affiliate at FDC and above FMP. This means that the utility is paying more for the goods, information, or services than what it should, and has necessarily compensated the affiliate above the lesser of FDC and FMP, therefore providing it a financial advantage. This would normally be prohibited under section (2)(A), which means that section (2)(F) now serves a purpose. However, that purpose is now solely to eliminate the prohibition of section (2)(A), thus permitting the imprudent subsidization of the utility's affiliate.

As was just shown, when procuring goods, information, or services, a utility will necessarily either be compliant with section (2) or else subsidizing its affiliate.⁹ If the transaction is compliant with section (2)(A), then section (2)(F) serves no purpose. In the later case, section (2)(F) serves a purpose but only by allowing the utility to provide a financial advantage to its affiliate. Because these are the only two possible scenarios, it can be concluded that section (2)(F) only functions when the utility is, by definition, providing a financial advantage to its affiliate.

A utility providing a financial advantage to its affiliate is the very definition of a utility subsidizing its affiliate.¹⁰ The stated purpose of the Rule, as filed, reads:

This rule is intended to prevent a Missouri Public Service Commission regulated electrical corporation, gas corporation, heating company, water corporation (with more than eight thousand (8,000) customers) or sewer corporation (with more than eight thousand (8,000) customers) from subsidizing its nonregulated operations.

(Emphasis added)

If section (2)(F) only applies when the utility is providing a financial advantage to an affiliate and it only serves to allow the utility to provide that financial advantage – which would otherwise be prohibited under section (2)(A) – then the sole purpose of section (2)(F) is to allow a

⁹ While not outlined here, the same is equally true for when a utility transfers goods, information, or services to an affiliate.

¹⁰ A subsidy is defined as “a grant or gift of money or other property made by way of financial aid” Webster’s New International Dictionary 2279 (3rd ed. 1976).

utility to subsidize an affiliate. If the sole purpose of section (2)(F) is to allow a utility to subsidize an affiliate but the purpose of the Affiliate Transactions Rule in general is to prevent utilities from subsidizing their affiliates, then the entire provision is necessarily “contrary to the purposes and intent of the Affiliate Transaction Rule,” as stated in proposed section (2)(F) itself. Thus, having the language in section (2)(F) that prevents that subsection from applying if the Commission finds, “after notice and a hearing, that such practice is contrary to the purposes and intent of the Affiliate Transaction Rule” serves no purpose because that will always be the case.¹¹ For all these reasons, the Commission should not utilize the currently proposed section (2)(F).

IV. Solution: Append Proposed Section (2)(F) to the End of Proposed Section (2)(B)

The various Affiliate Transaction Rules currently in effect (which are all primarily the same) included under section (2) a provision (B) that reads:

Current Section (2)(B): Except as necessary to provide corporate support functions, the regulated [utility] 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.

This is of course directly comparable to the Proposed Rule’s section (2)(B) which reads:

Proposed Section (2)(B): A covered utility shall conduct its business in such a way as not to provide any preferential position to an affiliated entity over another entity at any time.

It appears the Proposed Rule’s section (2)(B) is meant to reflect the existing rules’ section (2)(B) and, apart from some minor grammatical changes, the only real difference is that the existing rules have a clause that reads “Except as necessary to provide corporate support functions,” at the beginning. This is the only time that the concept of “corporate support functions” is ever raised in

¹¹ Importantly, section (2)(F) as proposed references FDC only. If the Commission promulgates this section as proposed, utilities will have no incentive to obtain the information necessary to determine the FMP for their corporate support services. In that instance, other parties’ ability to argue the prudence of obtaining those services from the utility’s affiliate will be greatly hindered.

As an illustrative example, let’s return to the *Missouri Utility Co.* example above. If section (2)(F) operated as proposed and *Missouri Utility Co.* obtained its corporate support services from *American Support Co.* for \$500,000, there would likely be no information available to determine whether *Missouri Utility Co.* could have obtained those services at a lower cost on the open market. This is because *Missouri Utility Co.* will have no incentive to either engage in a competitive bidding process or a benchmarking study to determine the FMP for those services. Other parties would also not have the information necessary or the time to complete this process on their own. Without this information it would be extremely difficult to argue the prudence of obtaining the corporate support services from *American Support Co.*, the affiliate. This is another reason why the current language of the Proposed Rule that references a Commission finding does not protect ratepayers from a utility providing its affiliate with a financial advantage.

section (2) of the existing rules. Given these facts, there appears to be a simple solution to the current problem: make the existing subsection (2)(F) only prevent application of subsection (2)(B), if applicable.

If the language of section (2)(F) was amended to the end of the existing subsection (2)(B) in such a manner that it only applied to subsection (2)(B), it would eliminate the problem outlined herein.¹² Please remember, these problems only arise because section (2)(F) is eliminating the prohibition on providing a financial advantage found in section (2)(A). This is an easy and simple change that would bring the Proposed Rule more in line with the existing rules while still protecting the intended purpose of the Affiliate Transaction Rule as a whole. The OPC therefore recommends that the existing language of subsection (2)(F) be moved into the body of subsection (2)(B) and that the language be clarified to indicate that it only applies to that subsection.¹³

¹² If amended as the OPC recommends, subsection (2)(B) would read:

A covered utility shall conduct its business in such a way as not to provide any preferential position to an affiliated entity over another entity at any time. This subsection shall not apply to or prohibit any of the following unless found by the commission, after notice and a hearing, that such practice is contrary to the purposes and intent of the Affiliate Transaction Rule:

1. The joint provision of corporate support services, at FDC, between or among a covered utility and any affiliate. This includes joint provision of corporate support services by an affiliated service company.
2. The provision, at FDC, of goods, information, or services of any kind between or among a covered utility and an affiliate regulated by the Commission or other state utility commission.

¹³ An alternative solution would be to change the language of section (2)(F) to read “Subsection (B) of this section shall not apply” This would accomplish the exact same goal as the proposed change offered by the OPC. However, if this change were to be made instead of what the OPC has recommended, it would be prudent for the Commission to re-organize the list of subsections under section (2) so that what was (2)(F) would immediately follow what is now (2)(B).