

COMMENTS ON SECTION (2)(F)

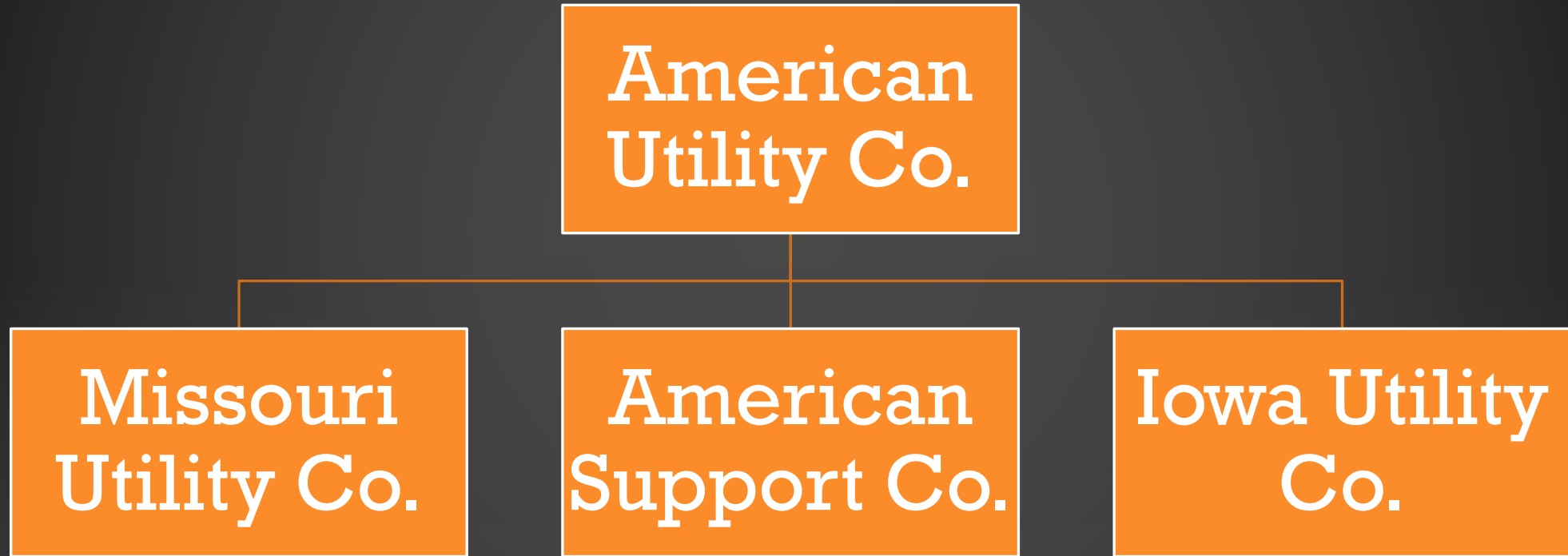
PURPOSE OF THE AFFILIATE TRANSACTION RULE

- This rule is intended to prevent a utility from subsidizing its nonregulated operations
- The rule's whole operation is centered in section (2)(A):
 - “A covered utility shall not provide a financial advantage to an affiliate”

FINANCIAL ADVANTAGE

- When buying from affiliate:
 - The utility pays above the lesser of fair market price or fully distributed cost
- When selling to affiliate:
 - The utility is paid below the greater of fair market price or fully distributed cost

SIMPLE EXAMPLE: *MISSOURI UTILITY CO.*



SIMPLE EXAMPLE: *MISSOURI UTILITY CO.*

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

CHANGE DUE TO PROPOSED RULE SECTION (2)(F)

- Section (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.

BACK TO THE EXAMPLE

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

SECOND EXAMPLE: REGULATED ENTITY

- *Missouri Utility Co.* enters into purchase power agreement to buy energy from *Iowa Utility Co.* at the cost for *Iowa Utility Co.* to produce the energy but well above the SPP market price for that energy
- This means *Missouri Utility Co.* is subsidizing *Iowa Utility Co.*

PROPOSED “SAFEGUARD” DOESN'T WORK

- Section (2)(F) includes language that says “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”
- This does not work for 2 reasons:
 - Providing a financial advantage is always contrary to the purposes and intent of the Affiliate Transaction Rule
 - There will be no evidence of FMP because of rule changes

FINANCIAL ADVANTAGE IS ALWAYS CONTRARY

- “This rule is intended to prevent a Missouri Public Service Commission regulated [utility] corporation . . . from subsidizing its nonregulated operations.”
- To “subsidize” is to grant or gift money or other property by way of financial aid
- Allowing a utility to provide a financial advantage to its affiliate is therefore by definition contrary to the stated purpose of the rule

PROPOSED RULE ELIMINATES EVIDENCE

- Proposed Rule amends evidentiary standards:
 - When a covered utility purchases information, assets, goods, or services from an affiliate, other than those listed in subsection (2)(F) of this rule, the covered utility shall either determine a FMP for such information, assets, goods, or services or demonstrate why no reasonable FMP can be determined.
- If rule (2)(F) applies, then there is no FMP evidence period

RESPONSE TO AMEREN'S COMMENTS

- Claiming that a shared services company is not operated at a profit does not eliminate the issue
- There is no prudence evaluation for shared service company costs except by comparing them to third party alternatives
- That is the purpose of the affiliate transaction rule

SIMPLE SOLUTION: BENCHMARKING

- **Existing Section (3)(A):** When a regulated [utility] purchases information, assets, goods or services from an affiliated entity, the regulated electrical corporation shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.

SIMPLE SOLUTION: BENCHMARKING

- **Existing Section (3)(D):** In transactions involving the purchase of goods or services by the [utility] from an affiliated entity, the regulated electrical corporation will use a commission-approved CAM which sets forth cost allocation, market valuation and internal cost methods. This CAM can use benchmarking practices that can constitute compliance with the market value requirements of this section if approved by the commission.

SIMPLE SOLUTION: BENCHMARKING

- **Proposed definition of Fair market price:** Fair market price (FMP) means 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. A covered utility shall make such determination based on competitive bids, if feasible. If not feasible, surveys, third-party studies, specific price inquiries, benchmarking, or any other reasonable method may be employed for this purpose. For goods or services for which there is no readily available comparative market price, the price shall be the fully distributed cost of the entity supplying the goods or services. The covered utility shall have the burden of demonstrating its method of determining FMP is reasonable, and/or that there is no readily available comparative market price for a given good or service.

THE MIDDLE GROUND

- Maintain section (2)(A) but require utilities to show that the joint provision of corporate support services from an affiliate to (or from) a covered utility is consistent with fair market price using benchmarking or similar standards

With (2)(F)	Without (2)(F)
<p>No oversight of costs charged by affiliate corporate support service companies</p>	<p>Costs charged by corporate support service companies are checked against market norms</p>
<p>No evidentiary standards to show what reasonable market costs are</p>	<p>Market costs can be set using benchmarking or similar standards</p>
<p>Utilities free to subsidize other regulated operations (Section (2)(F)2)</p>	<p>Utilities not permitted to subsidize other regulated operations (whether in state or out of state)</p>

CONCLUSION

How will you know if the shared service company costs are reasonable if there is no prudence evaluation and the affiliate transaction rule does not apply?