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August 2, 1999

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

FILED
AUG 2 1999
Missouri Public
Service Commission

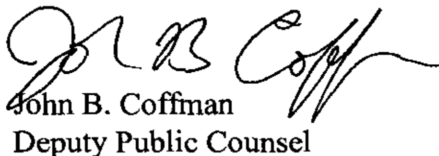
RE: Affiliate Transaction Rulemaking,
Case Nos. EX-99-442 and GX-99-444

Dear Mr. Roberts:

Enclosed for filing in the above referenced case, please find the original and 14 copies of the **Reply Comments of the Office of the Public Counsel**. Please "file stamp" the extra enclosed copy and return it to this office. I have on this date mailed, faxed, or hand-delivered the appropriate number of copies to all counsel of record.

Thank you for your attention to this matter.

Sincerely,



John B. Coffman
Deputy Public Counsel

JBC:kh

Enclosure

FILED
AUG 2 1999
Missouri Public
Service Commission

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

REPLY COMMENTS OF THE OFFICE OF THE PUBLIC COUNSEL

Proposed Rule 4 CSR 240-20.015
Electric Utilities Affiliate Transactions
Case No. EX-99-442

Proposed Rule 4 CSR 240-40.015
Gas Utilities Affiliate Transactions
Case No. GX-99-444

August 2, 1999

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OFFICE OF THE PUBLIC COUNSEL REPLY COMMENTS
AFFILIATE TRANSACTION RULEMAKINGS
FOR ELECTRIC AND GAS UTILITIES
CASE NOS. EX-99-442 AND GX-99-444

Introduction

At the outset of these Reply Comments the Office of the Public Counsel ("OPC") notes that remarks included herein are responsive to utility respondents who have filed Initial Comments in Case Nos. EX-99-442 *and* GX-99-444. As the Missouri Public Service Commission (hereinafter "Commission") is well aware, the Proposed Rules for electric and gas affiliate transactions – other than gas "marketing" affiliate transactions – are nearly identical. The various utilities responding have filed either *one* document containing Initial Comments for both cases, or alternatively, nearly identical comments in each case. Accordingly, the OPC's comments offered herein are being concurrently filed in both of the above-referenced cases. Thus, the term "Proposed Rules" used in these Reply Comments refers to the Proposed Rules from Case Nos. EX-99-442 and GX-99-444.

A quick review of relevant excerpts from opening or closing comments prepared by utility respondents included below gives one a quick appreciation for the various Missouri energy utilities' sentiments regarding the Proposed Rules issued by the Missouri Public Service Commission (hereinafter "MPSC" or "Commission") on June 1, 1999:

> MGE opposes the proposed rule (4 CSR 240-40.015). If it takes effect as written, the proposed rule promises to increase rates paid by utility customers while at the same time restricting earnings opportunities for utility companies. If it takes effect as written, the proposed rule also promises to stifle innovation and efficiency on the part of utility companies while at the same time thwarting customer choice. If it takes effect as written, the proposed rule promises to engender litigation, and probably even legislative activity, to remind the Commission that the scope of its authority extends only to public utility services. In a nutshell, the proposed rule embodies the worst of all worlds. (MGE Comments, Case No. GX-99-444, page 1)

> As issued, the Proposed Rules would ensure that Missouri utilities could not effectively engage in non-regulated efforts to enhance their financial status or, at best, be "last among competitors." Moreover, because of the asymmetrical pricing provisions in the Proposed Rules, and the broad definition of "affiliate transaction," it is likely that utilities would not even be able to conduct routine utility transactions and other efficient practices that have economically benefited their customers for years. It is also difficult to overstate the detrimental cost impact that these numerous requirements would have on Missouri utilities and their customers. Because numerous provisions of the Proposed Rules are so ambiguous in their meaning, and so uncertain in their potential application, it is virtually impossible to provide a definitive estimate of their impact. Based on their preliminary review of the Proposed Rule's provisions, however, the Missouri Utilities believe that they are likely to cost them and their ratepayers literally millions of dollars in added expenses or foregone revenues on an annual basis. ("Missouri Utilities" Comments, Case Nos. GX-99-444 and GX-99-445, pp. 12-13)

> The proposed rule is unnecessarily broad, inflexible, and heavy-handed, especially in light of the existing regulatory mechanisms applicable to Ameren. Though the rule currently proposed by the Commission is intended to benefit consumers, it actually imposes onerous burdens and, particularly as applied to Ameren, destroys many of the consumer-benefiting efficiencies that arise from the relationship between a utility and its affiliates. Ironically, this result is exactly contrary to the Commission's purpose of assuring that ratepayers are not adversely impacted by the utilities' non-regulated activities. (Ameren Initial Comments, pp. 1 - 2)

> If adopted, the rule will diminish managerial freedom and flexibility, and significantly increase transaction costs. Provided it survives judicial scrutiny, it is likely that the proposed rule's onerous requirements will discourage utilities from forming beneficial relationships with unregulated companies, and impede the growth of internal unregulated activities by regulated utilities to the detriment of consumer welfare. The Commission should fashion a rule that prevents cross-subsidies, but does not suppress unregulated activities. (Kansas City Power and Light Company Initial Comments, page 2).

The utilities' collective response to the Proposed Rules... "don't fix it 'til its broke." If we begin to abuse the ratepayers then, and only then, promulgate appropriate rules. Impose upon us only "light-handed regulation." Beyond the sweeping introductions and conclusion such as quoted above, the utilities collectively pick at, and gripe about, nearly every definition and requirement within the Proposed Rules.

Do the utilities' collective comments consist of superfluous legalese designed to disguise a real intent to be able to leverage their overwhelming market clout for monopoly services into superior results for their affiliates in selling competitive goods and services – primarily to their shareholders' economic advantage? Or do the utilities' comments consist of legitimate

complaints that, if left unattended, will tend to increase the price of regulated utility service and thwart – rather than enhance -- competition?

The Missouri Office of the Public Counsel ("OPC") submits that the utilities have raised some legitimate concerns regarding the Proposed Rules as written. The OPC believes that within its Initial Comments and attendant amendments to the Commission's Proposed Rules it has anticipated many of the "legitimate concerns" raised by the various Missouri utilities. Furthermore, upon consideration of the various Missouri utilities' Initial Comments and further reflection upon certain issue areas, the OPC is herein offering additional concessions that are responsive to certain utility positions that may also represent "legitimate concerns." That said, the OPC respectfully submits that many of the Missouri utilities' Initial Comments do consist of exaggerated statements and conclusions, "worst case" scenarios and elegantly-worded legalese intended to persuade this Commission to "throw out the baby with the bath water." The definitions, broad concepts -- and in many instances – the exact or similar language and detailed requirements of Missouri's Proposed Rules have already been adopted by other federal and state regulatory agencies. Contrary to impressions this Commission may experience upon a quick read of the Missouri energy utilities' collective comments, the Proposed Rules are ***not*** abusive, unfair, unduly burdensome, arbitrary, anti-competitive or unique in the industry. Indeed, as discussed later, the Proposed Rules closely follow the Guidelines for Cost Allocations and Affiliate Transactions that were adopted by the National Association of Regulatory Commissioners (NARUC) at its 1999 Summer Meeting..

Several utilities have noted an absence of affiliate abuses to date as justification for scrapping or significantly limiting the requirements of the Proposed Rules. Missouri Utilities states "... more than three years after the subject of affiliate rules was first broached, the proponents of the current Rules have yet to provide any concrete examples of affiliate or competitive abuses that would, in any way, warrant imposition of the extraordinarily burdensome requirements set forth in those Rules." (Missouri Utilities, Initial Comments, pp. 2 - 3). In response to such "don't fix it 'til it's broke" arguments, the OPC would first remind the Commission of events cited in Section III of our Initial Comments which do constitute what the OPC believes to be "abuses" under any reasonable code of conduct standards.

Second, the limited items of abuse noted within OPC's Initial Comments were identified outside the context of this affiliate transaction rule making docket. The OPC did submit limited discovery in this case designed to preliminarily identify areas of abuse – or potential areas of abuse. However, such limited discovery does not constitute, in any fashion, a full-scale audit or inquiry into Missouri utilities' relationships or transactions with their various affiliates. Additionally, the efficacy of the limited review that OPC attempted to perform in this case was severally constrained by the refusal (or asserted inability) of most utilities to answer OPC's data requests in a timely manner -- and sometimes a refusal to answer at all. A full scale review would likely identify further problems beyond those inadvertently identified in other regulatory proceedings.

Third, the OPC notes that while most Missouri energy utilities are beginning to "dabble" in more non-regulated businesses, such activities are generally within the experimental stage, or at most, only in the preliminary stages of development or implementation. Thus, given the infancy of these product and service lines, the number of transactions and types of dealings between the utilities and their affiliates have been fairly limited to date. However, this is likely to change in the near future. A cursory examination of the recent Annual Reports that Missouri's energy utilities have sent to their shareholders is all that is necessary for this to be confirmed. For example, the most recent Laclede Gas Company annual report states at page 2 that "[w]e will continue and expand efforts to sell not only gas appliances, but energy-related services, some of which may involve unregulated operations."

Fourth, we note that within its Initial Comments filed in Case Nos. EX-99-442 and GX-99-444, the Missouri Public Service Commission Staff stated, in part:

> The Staff has observed affiliate transactions that are detrimental to the ratepayer, causing the ratepayer of the regulated utility to pay excessively high prices for goods and services that the regulated utility could have purchased from a non-affiliated entity at lower prices. These excessively high prices are designed to create excessive profits for the non-regulated affiliated entity to the benefit of the shareholders and to the detriment of ratepayers of the regulated entity.

Thus, while not going into detail, such comments indicate that the Missouri Staff has, at least on occasion, observed affiliate transactions that have been detrimental to ratepayers.

Fifth, we note that many of the same utilities that cite a lack of documented affiliate abuse as support for their assertion that only minimal, if any affiliate rules are needed for the energy industry in Missouri, have refused to answer some or all of the data requests (DRs) that OPC has issued in this case. Almost all of the utilities to which OPC sent DRs to in this case have refused to answer questions that were either the same or similar to DRs that have led to the documentation of affiliate abuse in other cases. The position of many utilities seems to be – the Commission Staff and Public Counsel have presented little in the way of specific allegations regarding affiliate abuse in this case so only minimal rules or no rules are needed while at the same time they assert the Commission has no authority to require access to the types of information that could lead to the documentation of affiliate transactions that: are harmful: (1) to ratepayers and (2) to the development of competitive energy markets. While restrictions on the use of confidential information prevent OPC from providing timely detailed information regarding harmful affiliate transactions to the Commission in this case, Public Counsel would remind the Commission that we have provided the Commission with detailed documentation of such transactions in a couple of recent cases.

We therefore encourage the Commission to ignore certain utilities' hyperbole that draws to a conclusion to simply scrap any plans to issue needed affiliate transaction rules. Rather, the appropriate course is to separate legitimate concerns from exaggerated claims, and ultimately fashion rules that are clear and equitable for all stakeholders. As set forth within OPC's Initial Comments, the OPC believes the Proposed Rules could be improved and enhanced with certain additions. However, generally, the Proposed Rules as written incorporate essential and equitable concepts that should be adopted.

Several gas and electric utilities have offered similar or identical positions and complaints regarding the Proposed Rules. In an effort to avoid becoming repetitive or duplicative, the OPC will, for the most part, address within these Reply Comments issue areas in the aggregate rather than addressing each Missouri utilities' Initial Comments pleading-by-pleading or line-by-line.

Many Utilities Have Claimed That the Proposed Rules Are Unworkable in That a Number of Terms Are Undefined or Vague. Such Criticisms Can Be Easily Addressed by Adding a Short Clarifying Section to the "Standards" Section of the Proposed Rules

Some utilities have claimed that the Proposed Rules, as written, are simply unworkable given that many terms are undefined and/or loosely defined. For instance, United Cities/Greeley Gas Companies state that the definition for "preferential service" is ambiguous, over-broad and lacks a proper focus. Ameren argues that the term "unfair advantage" is left undefined – leaving it impossible to know what actions are permissible or impermissible.

OPC believes that the Proposed Rules, with the modifications proposed by the OPC in our Initial as well as within these Reply Comments, are sufficiently detailed so as to give guidance and reasonable assurance as to what is expected of the utilities and their affiliates to be in compliance with such rules. One could argue, as the utilities appear to be doing, that there are other actions or inactions – not specifically addressed within the rules – which might haunt the utilities. If that is the utilities' or this Commission's concern, such confusion could be easily and expeditiously resolved with a minor addition to the Proposed Rules.

Specifically, OPC submits that language, such as the following, could be added as a final subpart to the Standards section of the Proposed Rules:

(G) A regulated electric/gas corporation shall be deemed to have provided no preferential service or any financial advantage to an affiliated entity so long as it has complied with all other Nondiscrimination Standards of Conduct for Affiliated Entities and other Standards as set forth in Sections (2) and (3) of 4 CSR 240-20.015 / 4 CSR 240.40.015.

With this minor addition, OPC submits that the Proposed Rules should achieve the clarity and definition that some utilities claim are lacking in the rules as now written. However, if the Commission concludes that such amendment is necessary to clarify the Proposed Rules, OPC submits that the additional "conduct" standards contained within OPC's Initial Comments become all the more essential. Indeed, if the amendment set forth above is adopted *without concurrent adoption of OPC's additional code of conduct requirements* as set forth within

OPC's Initial Comments, the utilities will, in effect, be able to provide "preferential service" and/or a financial advantage to affiliated entities in the areas of name/logo sharing, joint advertising, joint marketing, tying, sharing of employees as well as in the sharing of plant, facilities, equipment or other costs. If any or all of these OPC-proposed code of conduct standards are rejected, the clarifying amendment listed above, which severely constrains the definition of "preferential service" and "financial advantage," should also be ignored.

As an alternative, in the event that the Commission does not accept some or all of OPC's Nondiscrimination Standards of Conduct for Affiliated Entities, Public Counsel recommends that the definition of Preferential Service be expanded to clarify the meaning of the term "an unfair advantage over its competitors." This could be accomplished by adding the following sentence to this definition:

A utility's affiliate gains an unfair advantage over its competitors when a regulated utility provides resources to its affiliated entity that were acquired through the provision of regulated utility service where such resources cannot be either obtained or replicated internally by the affiliate's competitors in a reasonable amount of time and for a cost that is similar to the price that the utility charges its affiliate for the same resource.

Adoption of OPC's Recommended Rule Regarding "Corporate Support" Should Eliminate Various Utilities' Criticisms of Burdensome Record Keeping Requirements and Evidentiary Standards, as well as the Impracticality and Inequity in Requiring Utilities to Offer Comparable Services to Non-affiliated Competitors.

The Proposed Rules require, among other things, an asymmetrical pricing standard for the exchange of goods and services between utilities and their affiliates ((2) (A) Standards). Under such asymmetrical pricing standards, goods and services transferred by the utility to the affiliate are to be priced at the higher of fully distributed cost (FDC) or fair market value (FMV). Conversely, goods and services transferred by the affiliate to the utility are to be priced at the lower of fully distributed cost or fair market value.

The Commission's Proposed Rules also currently require that the regulated corporation shall not provide "preferential service, information or treatment to an affiliated entity over another party." ((2) (B) Standards) Thus, under this provision of the Proposed Rule, any service offered by the regulated utility to its affiliate that could be interpreted to cause an "unfair advantage" must be offered to non-affiliate competitors on comparable terms. Finally, the Proposed Rules require record keeping conditions that will allow verification of the fully distributed costs as well as fair market value of every good and service exchanged – to ensure compliance with the asymmetrical pricing standards contained in the rule.

While the various Missouri utilities generally oppose each and every rule or requirement as noted above, in particular they issue a loud and near-unanimous cry regarding how such Proposed Rules are unfair and prohibitive with regard to various administrative and support functions. Specifically, the utilities note that it would be extremely burdensome, if not outright impossible, to obtain and maintain dual accounting and reporting of "fully distributed cost" amounts as well as a "fair market value" for each administrative support function -- such as accounting, legal, human resource, management or other administrative functions -- provided by the utility or service subsidiary to each non-regulated affiliate. Furthermore, the utilities note that if they are to provide such administrative support functions for their non-regulated affiliates, pursuant to the Proposed Rules' "non-preferential treatment" requirements, they must also offer such services to non-affiliated competitors. Public Counsel believes that this is only required by the proposed rules in those instances where the services can be categorized as affording an "unfair advantage" to an affiliate of a regulated utility.

The utilities argue that the asymmetrical pricing and reporting standards as well as the requirement to offer comparable services to non-affiliate competitors are so onerous so as to ensure that utilities will never offer or share such support functions. Ultimately, the utilities argue that the rules are so burdensome and restrictive that they virtually ensure that ratepayers will never be able to enjoy the benefits of economies of scale and scope that could result from growth through diversification.

The OPC would acknowledge that the Missouri utilities have raised a "legitimate concern" regarding the Proposed Rules' impact upon the provision or sharing of *administrative support functions*. The OPC would agree that the Proposed Rules, without modification, may lead to a conclusion that administrative support functions could seldom be shared between the utility and its affiliates. If they were shared, it would probably only be after obtaining a number of variances for various requirements within the Proposed Rules or a favorable interpretation by the Commission finding that the sharing of some or all corporate support services does not cause an "unfair advantage" to an affiliate of a regulated utility. However, the OPC has anticipated the noted problems regarding administrative support function embodied within the Proposed Rules. Within its Initial Comments the OPC has carved out a proposed exception to the "preferential treatment" standards of the Proposed Rule with regard to "corporate support functions." Specifically, the OPC has recommended the following "exception" to the conduct "standard" with its recommended subsection (3) (B) to OPC's Proposed Rules:

> ***(B) Except as necessary to provide corporate support functions, the regulated electric/gas corporation shall conduct its business in such a way as not to provide any preferential service, information or treatment to an affiliate entity over another party at any time. (underline for** emphasis added in this insert only)*

In particular, the OPC expresses its agreement with a number of Missouri utilities' conclusion that it would be virtually impossible for the regulated utilities to offer several support functions -- such as legal services, human resources, employee records and pension management -- to the affiliates' competitors. In fact, a blanket requirement for utilities to offer such services would lead to unavoidable conflicts of interest for departments or affiliates attempting to provide such service to any competitor requesting such service. Furthermore, certain functions that arguably could be interpreted under the Commission's Proposed Rule to be required to be offered to competitors would, more precisely, fall under the definitional umbrella of "corporate ownership" or "oversight." For instance, utilities might undertake shareholder services/relations functions and financing activities that, arguably, could be interpreted under the Proposed Rules as being required to be offered to competitors. Here again, the OPC does not believe this would be a reasonable requirement – if indeed it were ever envisioned under the Proposed Rule. Accordingly, the OPC reiterates the importance, equity and avoidance of undue burdens in

adopting its recommended "exception" to the Proposed Rules' code of conduct as set forth within OPC's suggested subsection (3) (B) above.

In our Initial Comments the OPC has already suggested that an "exception" for "corporate support functions" be carved out of the "preferential treatment" standard – thus eliminating the requirement that utilities offer such corporate support functions to competitors. The OPC did not propose a similar exception with regard to the Proposed Rules' FDC/FMV pricing, reporting and record keeping requirements. Upon a reading of the various Missouri energy utilities' Initial Comments and upon further reflection on the issue, the OPC would acknowledge that it also would be reasonable to carve out a similar exception for the pricing, reporting and record keeping requirements. Specifically, the OPC is herewith recommending the following addition to the Proposed Rules' "Standards"

(A) Except as necessary to provide corporate support functions, ***a regulated gas/electric corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated gas/electric corporation shall be deemed to provide a financial advantage to an affiliated entity if –*** *(*Underlined portion represents OPC's suggested change. Remaining portion of this "Standards" section remains as original version*)*

Additionally, a separate sub part to the "Standards" section, such as the following, needs to be added to insure that "corporate support functions" will be charged to affiliates utilizing a "fully distributed cost" methodology.

(F) Corporate support functions shall be assigned to all affiliated entities by the utility or any service corporation providing such corporate support functions to the utility and its affiliated entities utilizing a fully distributed cost methodology.

There are certain corporate support functions -- such as accounting and employee/payroll record keeping services -- that a utility could offer its non-regulated affiliates that might legitimately and reasonably be offered to the affiliates' competitors. Similarly, the utility and its affiliates could obtain a higher "fair market value" for such noted services that could be assessed the utilities' affiliates in lieu of a lower "fully distributed cost" amount. Here again, however, the OPC agrees

with many of the Missouri utilities that there needs to be some reasonable limitation regarding corporate support functions that the utilities should have to offer to competitors and for which they should be required to obtain a "fair market value" to charge the utility's affiliates. Accordingly, the OPC is herein proposing an additional modification to the rule – as embodied within the revised "Standard" sub part listed above.

If the Proposed Rules are modified, as OPC has recommended with a "corporate support function" exception to the asymmetrical pricing standards and related FDC/FMV reporting/record keeping requirements, the OPC submits that application of the Proposed Rules' pricing and conduct standards to the balance of goods and services exchanged between utilities and their affiliates is reasonable. Indeed, the OPC submits that if the "corporate support function" carve out that the OPC recommended within its Initial Comments had been included within the Commission's Proposed Rules, it is likely that a significant portion of the criticisms and complaints of the Proposed Rules contained within the various Missouri utilities' Initial Comments would have been eliminated.

If Under Certain Scenarios Application of the Asymmetrical Pricing Standards and Related FDC/FMV Reporting and Record Keeping Requirements Are Thought to Remain Burdensome Even After Allowing an "Exception" for "Corporate Support Functions," the Appropriate Remedies Should Include Utility Applications for a Variance or Minimum Dollar Thresholds.

The OPC submits that if the "exception" for corporate support functions is adopted then most, if not all, of the utilities' "legitimate concerns" regarding the transfer pricing and report/record keeping requirements should be quelled. Specifically, the OPC submits that, with the corporate support function "exception," the transfer pricing and other "no preference" conduct requirements regarding the exchange of goods and services between utilities and their affiliates are reasonable, equitable and should not be unduly burdensome to comply with.

Notwithstanding such belief, the OPC is cognizant that the Missouri utilities will likely continue to claim, even with a corporate support function "exception" from pricing and reporting

standards, that the Proposed Rules remain onerous and burdensome. It is difficult to envision the types or magnitude of goods and services that would be exchanged between utilities and their affiliates – beyond corporate support functions – that would be so numerous and so complex so as to cause a "burdensome" or "onerous" pricing, accounting and/or reporting imposition. Nonetheless, if after the corporate support function "exception," there remains scenarios or situations wherein implementation of the preferential treatment, pricing and recording/reporting standards that result in a burdensome imposition that is not "in the best interest of its regulated customers," the regulated utilities have the ability – pursuant to Section (9) of the Proposed Rules – to seek and obtain a "variance" from such requirement. Thus, in the unlikely event the "standards" remain burdensome, even with an "exception" for corporate support functions, the utilities are free to make such claim by filing for a variance as provided for within the Commission's Proposed Rules.

Finally, if the Commission is concerned that the standards remain burdensome as they relate to small or infrequent transactions, it could impose minimum thresholds for compliance with the rules. For instance, Missouri Utilities has suggested within its proposed Modified Rules that the Record Keeping Requirements be limited to "[t]he number and amount of any single transaction or continuing service relationship between the utility service provider and affiliate with a value in excess of $50,000 per year, by affiliate." The OPC is not certain that such minimum threshold is necessary or reasonable. Nonetheless, adoption of such threshold minimum may be responsive to continuing complaints of "burden" by the utilities – and would be far superior and much more acceptable than simply scrapping the standards in their entirely. Public Counsel suggests that a threshold in the $20,000 to $50,000 range may be appropriate, depending upon the size of the utility. OPC would expect, however, that the Commission would impose appropriate sanctions if, following a rate case audit, it was determined that the utility or its affiliates were "gaming the system" to fly under the radar of the threshold minimums (i.e., somehow engaging in numerous small transactions that technically never exceeded the minimum threshold established).

Asymmetrical Pricing Should Remain as the Appropriate Standard. If Unique Situations Arise That Would Justify a Deviation from Such Standard, It Would Be Appropriate for Energy Utilities to Seek a Variance for the Specific Situation.

As discussed above, the various Missouri energy utilities were unanimous in their complaint that the asymmetrical pricing standard and attendant reporting and record keeping requirements would be burdensome and costly to implement. However, certain utilities offered conceptual arguments in opposition to the asymmetrical pricing standard that went beyond merely complaining about the "burden" that such Proposed Rule would impose. For instance, KCPL argues that "[s]o long as incremental costs of providing a good or service to a competitive affiliate are covered, ratepayers are fully protected." (KCPL Initial Comments, page 8). Empire District Electric Company states:

> Simply put, transactions should be allowed to occur at the prudent cost. That cost may be incremental, market, fully distributed or a combination. It is illogical to assume that transfers at only market or fully distributed cost will cause harm to the customers of the regulated entity. Under the proposal, costs to the customers of the regulated entity will be, in effect, subsidized by the customers of the non-regulated affiliate. (Empire District Electric Company, Initial Comments, page 2)

As OPC stated within its Initial Comments, upon first impression, the asymmetrical pricing standards may appear inequitable. However, as discussed in detail within OPC's Initial Comments, the proposed standards are indeed fair, and in fact, consistent with sound and equitable ratemaking principles. We will not again repeat such reasoning herein, but would incorporate by reference the support for asymmetrical pricing noted within OPC's Initial Comments, pages 27 through 30.

A fundamental premise upon which the asymmetrical pricing standard is built is the concept that utilities have an obligation to lower, to the maximum extent possible, the cost of service to captive utility customers who take an essential service from a monopolistic energy utility. The energy utility's cost of service can be lowered, in certain situations, by charging a market price to either an affiliated or non-affiliated entity that exceeds the fully distributed cost of providing the good or service. This Commission expects utility companies to shop for the best price possible when buying a good or service that is needed in the provision of monopolistic energy utility service from a non-affiliated entity. Similarly, this Commission expects energy utilities to

extract the maximum margin or profit that it can when selling non-utility services to non-affiliated entities. For instance, rents from pole rentals to phone or cable companies are to be maximized for crediting to utility customers through cost of service development. Similarly, this Commission has expected Missouri utilities to sell temporary or seasonal excess energy or capacity to other utilities at the maximum price the market will bear – with any such margin being reflected as a reduction to the retail cost of service. The Proposed Rules are designed to impose the exact same "arms-length" conduct between utilities and their affiliates that this Commission has expected from regulated utilities when the regulated utilities deal with non-affiliated entities.

KCPL argues within its Initial Comments for application of a different standard for pricing goods and services sold by the utility to its affiliates. Specifically, KCPL argues above that "ratepayers are fully protected" so long as the transfer price covers the utility's *incremental* cost of producing/providing the good or service. Thus, KCPL is essentially arguing for a "no detriment" standard to be imposed with regard to the transfer of goods and services from the utility to the affiliate. The OPC continues to urge this Commission to reject the more-lenient KCPL-proposed "no detriment" standard and adhere to the "minimizing cost of utility service" standard that is effectively embodied within asymmetrical pricing standards incorporated within the Proposed Rule. Furthermore, Public Counsel notes that a detriment would clearly exist when the utility provides resources to its affiliate at incremental cost when these same resources could have been sold to a non-affiliated entity at the higher market price.

The utilities' collective insurrection against asymmetrical pricing standards may cause this Commission to question whether such transfer pricing guidelines are unique to the industry or otherwise simply overly aggressive to the utility's disadvantage. The OPC would note, however, that asymmetrical pricing standards were recently endorsed by NARUC with passage on July 23, 1999 of a resolution (see Attachment 1) that adopted the Guidelines for Cost Allocations and

Affiliate Transactions. Such guidelines, which have been affixed to these comments as Attachment 2, state in part:

> Generally, the price for services, products and the use of assets provided by a regulated entity to its non-regulated affiliates should be at the higher of fully allocated costs or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanism as determined by the regulator.
>
> Generally, the price for services, products and the use of assets provided by a non-regulated affiliate to a regulated affiliate should be at the lower of fully allocated cost or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.

The attached NARUC documents contain guidelines that were developed after nearly two years of thought and discussion – including significant input from utility companies and their representatives. Notwithstanding formidable opposition by industry representatives who set forth many of the same arguments that the Commission has heard in this case regarding undue burdens and competitive issues, the NARUC has nonetheless endorsed asymmetrical pricing guidelines as the "generally" preferable transfer pricing standard.

While the OPC continues to support the asymmetrical pricing standards set forth within the Proposed Rules, the OPC readily admits that there *could* be situations wherein rigid adherence to the asymmetric pricing standards could have the result of *not* maximizing benefits to ratepayers. For instance, assume a scenario wherein the utility's incremental cost to provide a non-tariffed service was $10, the fully distributed cost to provide the service was $20 and the fair market value of providing the service was $15. Under the asymmetrical pricing standards contained within the Proposed Rules, the utility would be required to charge the fully distributed cost amount of $20. The affiliate, observing a lower available market price for the service, elects to buy the service from another vendor for $15 rather than incur the mandated higher FDC price of $20. Under this hypothetical situation, the utilities can argue, with merit, that if the FDC price is imposed, the transfer from the utility to the affiliate will not occur, and ratepayers will end up receiving no benefit from the transaction. If the utility had been able to charge the lower $15 FMV price for the service, a $5 profit above the incremental cost of providing the service would have been achieved and made available for crediting to ratepayers through cost of service development. Of course, the same set of circumstances should cause the utility to investigate

whether it might be able to lower its cost of regulated utility service by outsourcing this work and taking advantage of the $15 market price.

The solution to a unique situation such as described above is not to completely abandon the asymmetrical pricing standards set forth within the Proposed Rules. Rather, the remedy to address the hypothetical set forth above is to simply require the utility to file for a variance that demonstrates that rigid compliance with the rule "would not be in the best interests of its regulated customers." Of course, in its Proposed Rules the Commission has anticipated just such a unique occurrence and provided a variance provision that utilities may utilize.

Empire District Electric and other Missouri energy utilities will no doubt continue to argue for more flexible pricing standards such as the "prudent cost" or "incremental cost" standards discussed above. However, for reasons set forth in detail within our Initial Comments, OPC continues to urge adoption of asymmetrical pricing as the appropriate standard -- guidelines that are utilized by many other state commissions and endorsed by NARUC. Adherence to asymmetrical pricing should, in most situations, tend to maximize benefits for ratepayers. Adoption of any other standard, or simply allowing the pricing standards to be more flexible, would be an invitation for utilities and their affiliates to conduct their business operations in a manner so as to maximize benefits for shareholders rather than ratepayers. If in a given situation compliance with the asymmetrical pricing standards does not result in "the best interests of its regulated customers" the remedy would be to obtain a variance for that particular situation. If, over time, it appears that variances are becoming a frequent occurrence, the Commission may wish to revisit the equity or appropriateness of the standard. However, OPC urges the Commission to reject the various Missouri energy utilities' "cry wolf" at this point in time and adopt the asymmetrical pricing standards as written within the Proposed Rules.

Adoption of Various Additional Rules Recommended for Incorporation by the OPC Within Initial Comments Should Eliminate Certain Utilities' Claims That the Proposed Rules, or Terms Used Within the Proposed Rules, Are Vague or Undefined.

Several utilities have claimed that the terms used, or the Proposed Rules in their entirety, are ill-defined or vague. Ameren states:

> First, and most fundamentally, the rule is very vague. The term "unfair advantage" is left undefined. It is impossible to know what constitutes an "unfair advantage." (Initial Comments, page 24)

United Cities Gas Company and Greeley Gas Company state:

> Both of the proposed rules define "preferential service" as "information, treatment or actions by the regulated gas corporate which places the affiliated entity at an unfair advantage over it competitors." This definition, which is critical in defining the scope of the rule, is ambiguous, over-broad and lacks a proper focus. In the event the Commission decides that a definition should be included in a rule, it should be more precise so it can provide proper guidance as to what type of conduct is actually prohibited or restricted. It is the position of United Cities and Greeley that any rule that is unclear with regard to the specific actions it intends to encompass within its scope is fundamentally unfair. The language currently contained in the proposed rules could be construed to encompass virtually any type of activity involving a regulated gas corporation and its affiliates thereby making both compliance and enforcement extremely difficult (Initial Comments, page 3)

Once again, the OPC finds itself in partial agreement with certain utilities. It is largely because of some of the ambiguity in the Proposed Rules as written that OPC has recommended within Initial Comments a number of additions or amendment. Specifically, OPC is recommending precise rules dealing with use of names, transferring employees, joint marketing and the utility's dissemination of customer information that should significantly clarify the Proposed Rules. There may be other areas where specific codes of conduct would further clarify required or permissible actions under the rule. If the utilities have specific conduct that they would like to preserve – or eliminate from future interpretation -- they are free within this docket to propose such amendments. The Commission may or may not agree with such further delineation – but at least such conduct could then be specifically accepted or rejected, thus avoiding further interpretation or conflict. Once again, the appropriate action is to modify the Proposed Rules to clarify any confusion – and not to simply abandon the Proposed Rules because of the utilities' assertions that the rules are too "vague."

The Proposed Rules' Presumption That Control Is Achieved with Ten Percent (10%) Beneficial Ownership Is, If Anything, Liberal. The Missouri Energy Utilities' Proposals to Raise the Presumption of Control to Fifty Percent (50%) Ownership Should Be Rejected.

Several utilities objected to the Proposed Rules' rebuttable presumption of control beginning with ten percent (10%) beneficial ownership of voting securities or partnership interest. Most argued for achievement of fifty percent (50%) ownership for a presumption of control – stating that the presumption of ten percent (10%) ownership "is not supported by economic theory, empirical evidence of corporate control in such circumstances, or by the rules and practices of other enforcement agencies dealing with competitive matters such as the Federal Trade Commission("FTC"). (See Empire District Electric Company Initial Comments, page 2). It would appear that Empire District Electric does not recognize the Federal Energy Regulatory Commission ("FERC") as an "enforcement agenc[y] dealing with competitive matters." Indeed, if Empire were to recognize the FERC as such an "enforcement agency" it would have to concede that the federal agency tasked with regulating certain regulated gas and electric transactions has adopted the identical ten percent (10%) ownership threshold as is currently incorporated within Missouri's Proposed Rules.

The OPC notes that while no stated ownership percentage is established, the Federal Communication Commission recognizes that "control" can be established with "a minority ownership or voting rights of securities, common directors, officers, or stockholders, voting trusts, holding trusts, affiliate companies, contract, or any other direct or indirect means." (47 CFR Part 32.9000, October 1, 1998)

If Empire were to research other state regulatory agencies' affiliate transactions rules it would realize that certain regulatory agencies have adopted a *lower, five-percent (5%) ownership criteria* for presumption of control (i.e., California, Minnesota, Pennsylvania, Wisconsin, Minnesota, to name a few). Other states such as Illinois and New Jersey have adopted the same ten percent (10%) criteria that the Commission has proposed. OPC's research indicates that no state regulatory agency has adopted the ultra-conservative 50% criteria being suggested by Empire.

Public Counsel respectfully reminds this Commission that is has already accepted the Proposed Rules' definition for control. Specifically, the HVAC rules ordered in Case No. EX-99-263 adopt the exact same definition of "control" as has been proposed within this rulemaking docket. Finally, we note the ten percent (10%) control criteria is a "rebuttable presumption." This utility complaint appears to be yet another attempt to have a greater number of affiliate transactions fall under the radar of these affiliate transaction rules. We fully expect that any utility holding more than ten percent (10%) of the voting securities of an affiliate ***will not attempt*** to claim that it does not substantially control that entity. Nonetheless, the utility is always free to make such a claim – the Proposed Rule does not mandate a conclusion that the utility controls another entity with as little as ten percent ownership – it is only a rebuttable presumption.

The Proposed Rules' Reporting and Record Keeping Requirements Are Reasonable and Necessary. Any Cost Imposition Related to Such Requirement Is Warranted Given the Potential for Abuse in Their Absence.

The various Missouri energy utilities' Initial Comments are most vocal and united in their obvious disdain for the reporting and record keeping requirement contained within the Proposed Rules. However, OPC respectfully submits that without attendant record keeping and reporting requirements, the other worthy elements of the Proposed Rules will be difficult, if not impossible, to enforce. If the asymmetrical pricing standards are adopted without attendant record keeping requirements, it will be difficult and very time consuming during the course of a rate case audit to determine compliance with the rules.

If a utility claims, for instance, that the fully distributed cost rate that it is paying an affiliate for a good or service is below a comparable "fair market value," but keeps no contemporaneous records to demonstrate this assertion, it will likely be the Commission Staff or OPC auditor who will have to attempt to perform the leg work to accept or disprove this claim. Essentially, if the proposed record keeping requirements are not adopted, the burden of proof regarding compliance or lack thereof will be largely shifted to the rate case auditor. We remind the Commission that Missouri employs a historic test year approach in the rate making process. Accordingly, it may

be difficult for the auditor to obtain "fair market values" for goods and products purchased from an affiliate months after the transaction occurred.

Furthermore, excess utility earnings can be camouflaged with non-compliant pricing or allocation schemes. If costs can be shifted from affiliate to utility with relative ease and flexibility, the earnings reporting and "monitoring" function now in place will become relatively ineffective. The Commission may remember that during the 1995 - 1997 time frame that UtiliCorp United, Inc. unilaterally elected to allocate the majority of its significant "EnergyOne" development and implementation costs to captive retail utility customers. Such costs were clearly incurred to develop and promote its non-regulated products and services. When UtiliCorp was eventually brought before this Commission in a complaint proceeding regarding its excess earnings, UtiliCorp management did not even attempt to defend its prior-year marketing allocation scheme. However, unrestricted implementation of an indefensible allocation scheme served a valued service to UtiliCorp's shareholders – if only for a period of a year or so. By allocating very significant marketing costs incurred for its non-regulated products and services to the utility division, UtiliCorp's Missouri Public Service Division flew under the Staff and Public Counsel's earnings radar screen – retaining millions in earnings for its shareholders that this Commission ultimately determined to be "excessive."

As stated within in an earlier portion of these Reply Comments, OPC is somewhat sympathetic to the Missouri utilities' collective complaint regarding the Proposed Rules' record keeping requirements – as they relate to "corporate support functions." However, again, with the "exception" to the Proposed Rules that OPC is recommending regarding "corporate support functions," OPC believes that most, if not all, of the utilities' collective cries of "burden" relating to record keeping and reporting requirements are eliminated since the market value of these services would not need to be documented. OPC emphasizes that at least certain corporate support functions could be carried out by outside vendors or internally by a duplicate department within the affiliate's organizational structure. However, it is likely such scenarios would lead to higher costs for the affiliate. Thus, the "exception" for "corporate support functions" represents a significant concession that, if adopted, should significantly mitigate the utilities' costs and

allow the utilities and their affiliates to benefit from economies of scale and scope where it is appropriate to do so.

If the Commission is persuaded that the "exception" for the "corporate support functions" does not adequately alleviate the utilities' cry for relief from record keeping requirements, the second or alternative remedial action would be – as suggested earlier – for the Commission to implement a minimum financial threshold for record keeping requirements. As stated earlier, OPC is not convinced that such step is warranted – but nonetheless acknowledges that such additional action is far superior to merely scrapping or significantly altering the Proposed Rules' record keeping and reporting requirements.

The Proposed Rules' Requirement That Regulated Utilities Provide Information Regarding the Availability of Non-affiliated Competitors Is Reasonable Given the Regulated Utilities' Unique Government-endorsed Market Advantage.

Several utilities objected to the Proposed Rules' requirement in subsection (2)(D) that when a customer requests information from the regulated utility about goods and services provided by an affiliate that the regulated utility must also provide information regarding the availability of other, non-affiliated entities that provide the same goods or services. United Cities Gas/Greeley Gas Company state that "[m]any of these competitors, particularly in the gas marketing area, are large nationally recognized corporations with enormous marketing capabilities and as such, they certainly do not need any special protection from the Commission." (See Initial Comments, page 7).

Ameren joins in the criticism of this rule by stating:

> This rule does nothing to further the Commission's stated goal of preventing cross-subsidization. Instead, it can only be understood as a misguided and ineffective attempt to "level the playing field" between the utility's affiliates and competitors with those affiliates. It effectively places a utility's affiliates at a disadvantage vis-a-vis their competitors, as those competitors are not required to respond to requests for information by producing a list of companies that seek to take its business. (Ameren Initial Comments, page 26)

From comments quoted above, it is clear that most Missouri energy utilities would have the Commission believe that they are the ones that will be discriminated against if the Proposed Rule, requiring dissemination of information regarding the affiliate's competitors, is adopted as written. They often note that their competitors will not be burdened with comparable requirements to inform their customers of other competitors' ability to provide a given product or service. Upon first impressions, the utilities' argument may appear meritorious.

If one reasonably thought the Missouri energy utilities were likely to enter into highly competitive, mature markets for goods and services *other than energy or energy-related products*, one could more easily see merit in the utilities' position. If one truly believed that the Missouri energy utilities were likely to be entering into the fast food business, the grocery business or the entertainment business, one might logically conclude that the Proposed Rule regarding dissemination of information regarding competitors was unnecessary or overkill. OPC would agree that McDonalds, Price Chopper or AMC Theater do not require much protection from utility affiliates attempting to enter those industries.

However, OPC submits that, in all likelihood, energy utilities will tend to diversify into energy-related industries where they can best exploit their government-endorsed monopoly position. This view is consistent with the strategies contained in the numerous business plans of energy utilities that OPC has reviewed over the last few years. Realistically, it can be expected that if a utility customer inquires about a service of a utility's affiliates, that customer has probably done so because it has become aware of a utility's – or a utility affiliate's – entry into an energy-related market. To date – prior to implementation of the Proposed Rules – such inquiries have no doubt often been made as a result of the promotion of affiliates services on the monthly bill of regulated utilities. It is these so called "natural fits" that OPC believes the energy utilities have the greatest ability to exploit. It is also these markets that OPC contends need to protected from domination - or creation of entry barriers – by the utilities.

One other point needs to be emphasized. Subsection (2)(D) of the Proposed Rules require the dissemination of information regarding other non-affiliated entities *only if the utility customer requests information from the regulated utility.* If a customer calls the affiliate directly, the rule

does not require the affiliate to also provide a list of competitors. This is an important distinction. The purpose of the Proposed Rule is to effectively limit *the utility* from leveraging its market presence and name recognition – gained from government intervention in the market – to the advantage of its affiliate. If an affiliate receives calls *directly* from customers inquiring about non-regulated goods and services which it sells, such affiliate is under no obligation – pursuant to the Proposed Rules – to disseminate information regarding the availability of goods and services provided by its competitors.

In summary, the OPC's position on this issue is diametrically opposite to that of the various Missouri energy utilities. Within Initial Comments the OPC has recommended *as its primary position on this issue* that the utilities be strictly prohibited from providing customers with a list of service providers that include the utility's affiliates – even if such list includes or identifies the names of unaffiliated entities. As discussed in greater detail within our Initial Comments, the OPC believes that it is the local utility company – with its government-endorsed market power advantage – that will have the tremendous edge when entering into non-regulated businesses. Accordingly, OPC has recommended rejection of that part of the Proposed Rule regarding dissemination of any information regarding the utility's affiliates. *In the alternative*, if any information regarding the utility's affiliate is to be disseminated, OPC recommends that it be done with additional requirements or restrictions that will further insure that the utility cannot exploit its government-endorsed market clout. (See Alternative (2) (B) 2 in OPC's Proposed Rule submitted with Initial Comments.)

Different Types of Market Participants Have Different Opinions Regarding the Range of Regulations Required to Ensure That a Utility's Affiliate Will Not Gain an "Unfair Advantage" Over Its Competitors.

Views on the need for "no preference" and other code of conduct provisions depend on the different interests of the various stakeholders. Incumbent utilities want – at most -- very limited regulations in so far as such regulations would hinder their ability to compete successfully, to leverage any advantage they may possess (including any government-endorsed market advantage) or to create barriers to entry. Along these lines, several utilities claim that the "no

preference" requirement will actually harm consumers by tilting the playing field so that the utilities or their affiliates are handicapped to the point that they cannot compete with their unregulated competitors. These utilities state that the "handicaps" provided for within the Proposed Rules go beyond reasonable measures that would "level the playing field" by simply requiring that competitors have equal access to what they have narrowly defined as "essential" facilities. These utilities also argue that if the utility is able to facilitate growth through diversification, without impeding and costly regulation, that such growth will lead to economies of scale and scope that will in turn lead to *lower prices for consumers* of regulated and unregulated products and services.

New entrants would like to see provisions that would allow them to have a chance to successfully compete against the utility incumbent who starts with 100% of the energy commodity market. Such new entrants argue that utilities have a number of advantages -- such as size, name recognition, customer data and access to innumerable corporate support functions -- that will make successful entry difficult in the energy commodity market as well as any energy-related products and services markets. New entrants essentially argue that the transition from a monopoly market to a competitive market won't necessarily bring benefits to consumers unless the retail unbundled energy commodity market and the energy services markets that are related to it are structured and regulated in a way that facilitates entry by new providers. New entrants believe these transitional commodity and energy services markets will only lead to effective and sustained competition if many of the advantages associated with unique resources that the incumbent has acquired from its monopoly operations are made available to them on the same terms that these resources are made available to the incumbent's unregulated affiliates

Consumers – and presumably regulators – also want to see markets develop that have characteristics of effective and sustained competition. This requires that energy and energy-related markets be structured and regulated in a manner that will lead to effective and sustained competition in a reasonable period of time. Thus, consumers desire markets for energy-related products and services that will not have entry barriers due to incumbent advantages that would prevent the development of effective and sustained competition in these markets. At the same time, consumers require that transfer pricing rules are in place to protect them from the

incentives that monopoly providers will have to divert earnings to non-regulated activities and leverage incumbent monopoly advantages in markets for non-regulated energy services.

The above-noted polarized view points are laced throughout the various parties' Initial Comments as well as within various industry and academic publications that address the proper guidelines to be included within appropriate affiliate transaction rules. It is interesting to observe, however, that a utility's viewpoint can shift as it switches hats from "incumbent utility" to "new entrant." For instance, when UtiliCorp has participated in, or contemplated participating in, gas commodity sales markets as a new entrant, it has recognized a need for code of conduct provisions for gas marketing affiliates. In a 1996 Baltimore Gas and Electric Company (BGE) case before the Maryland Public Service Commission (Case No. 8709), UtiliCorp's gas marketing affiliates, Broad Street Oil and Gas Company and UtiliCorp Energy Solutions supported complete structural separation of the operations of BGE's marketing affiliate from BGE's regulated operations . However, when this **same utility** participates as a utility incumbent -- as UtiliCorp is in this case -- it believes a code of conduct is generally unnecessary or should be very limited. (Missouri Utilities Initial Comments, Case No. GX-99-444, page 6)

If an Exception for "Corporate Support Functions" Is Adopted, Ameren's Service Agreement Is Generally in Compliance with the Rules. Modifications to the GSA Resulting from Adoption of the Proposed Rules Should Be Relatively Insignificant.

Ameren claims within its Initial Comments that it is "unique" to other Missouri energy utilities in that it is a registered holding company pursuant to the Public Utilities Holding Company Act of 1935 (PUCHA). Pursuant to PUCHA, Ameren has established a "service company" that is authorized to provide centralized managerial, technical, legal and other support services to the two public utilities which it owns (i.e., UE and CIPS) as well as other affiliated companies.

Ameren further claims that Missouri ratepayers are already adequately protected from cross-subsidization inasmuch as the Securities and Exchange Commission ("SEC") requires that a "service company" provide these corporate support services *at cost*. According to Ameren, the pricing and reporting standards contained within the Proposed Rules are inconsistent with its

SEC-approved General Services Agreement which dictates cost assignment procedures to be used in allocating costs from the service company to the various affiliates – including the two public utility companies.

The OPC would agree that, absent an "exception" being granted for "corporate support functions," Ameren's existing GSA would be inconsistent the Proposed Rules. However, OPC believes that if the exception is granted for corporate support functions, the discrepancies between the GSA and the affiliate transactions rules would be de minimus or non-existent.

The OPC did not have the resources during the brief period of time allowed to prepare Reply Comments to conduct an audit or review of the cost allocation procedures employed pursuant to Ameren's SEC-approved Cost Allocation Manual ("CAM"). However, from a review of the General Services Agreement as well as the SEC's regulations guiding such document, it would appear that a "fully distributed cost" methodology would not be inconsistent with SEC regulations dictating cost assignment for services rendered. Specifically, SEC costing standards at 17 CFR 250.91 state:

> (a) Subject to the provisions of this section and any other applicable rule, regulation, or order of the Commission, a transaction shall be deemed to be performed at not more than cost if the price (taking into account all charges) does not exceed a fair and ***equitable allocation of expenses*** (including the price paid for goods) plus reasonable compensation for necessary capital procured through the issuance of capital stock (or similar securities of an unincorporated company).
>
> (B) Direct charges shall be made so far as costs can be identified and related to the particular transactions involved without excessive effort or expense. ***Other elements of cost, including*** taxes, interest, ***other overhead***, and compensation for the use of capital procured by the issuance of capital stock (or similar securities of an unincorporated company) shall be fairly and equitably allocated. ***(Emphasis added)***

The Proposed Rules define Fully Distributed Costs as follows:

> Fully distributed cost (FDC) means 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.

Thus, both the Proposed Rules' FDC methodology as well as the SEC guideline provide for allocating indirect or overhead costs to recipients of goods or services. The Proposed Rules' FDC methodology specifically requires the assignment of "all" costs whereas the SEC guidelines do not contain such exacting language. Again, OPC has not reviewed Ameren's CAM to see if ultimately "all" overhead or indirect costs are effectively assigned to benefiting affiliates. The OPC would certainly expect that they would be. However, in the event certain "overhead" costs are not currently being allocated or otherwise assigned to benefiting entities pursuant to the FDC guidelines, they certainly could be – and still be in compliance with the less-detailed SEC guidelines.

Assuming for the moment that OPC's assumption regarding the GSA's compliance with FDC is in error or otherwise significantly askew, OPC would remind this Commission of certain commitments that Union Electric made when seeking approval of its merger with Central Illinois Public Service Company. Specifically, in the Stipulation entered into by Ameren and other parties – and which was ultimately approved by this Commission – UE agreed that:

> UE, Ameren and each of its affiliates and subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of non-UE Ameren businesses by UE's retail customers. ***In the event that rules imposing any affiliate guidelines regarding accounting controls applicable to similarly situation electric utilities in Missouri are adopted, then UE, Ameren and each affiliate or subsidiary thereof shall become subject to the same rules as other similarly situation electric utilities in lieu of this paragraph. (emphasis added)***

This same Stipulation went on to provide:

> All contracts, agreements or arrangements, including any amendments thereto, of any kind between UE and any affiliate, associate, holding, mutual service, or subsidiary company within the same holding company system, as these terms are defined in 15 U.S.C. § 79b, as subsequently amended, required to be filed with and/or approved by the Securities and Exchange Commission ("SEC") pursuant to PUHCA, as subsequently amended, shall be conditioned upon the following without modification or alteration: UE and Ameren and each of its affiliates and subsidiaries will not seek to overturn, reverse, set aside, change or enjoin, whether through appeal or the initiation or maintenance of any action in any forum, a decision or order of the Commission which pertains to recovery, disallowance, deferral or ratemaking treatment of any expense, charge, cost or allocation incurred or accrued by UE in or as a result of a contract, agreement, arrangement or transaction with any affiliate, associate, holding, mutual service or subsidiary company on the basis that such expense, charge, cost or allocation

has itself been filed with or approved by the SEC or was incurred pursuant to a contract, arrangement, agreement, or allocation method which was filed with or approved by the SEC.

Thus, notwithstanding complaints contained within Ameren's Initial Comments about SEC protection from cross-subsidization, it is clear that UE has already agreed to make the SEC accounting and transfer pricing requirements subservient to any subsequent affiliate guidelines which this Commission may adopt.

At the risk of becoming repetitive, the OPC would again emphasize that adoption of an exception for corporate support functions relieves the arguably burdensome asymmetrical pricing, "no preference" to affiliates, record keeping and reporting requirements otherwise mandated by the Proposed Rules. With such exception, the OPC submits that for the balance of goods or services that utilities and their affiliates might exchange, the Proposed Rules are not unduly burdensome or restrictive.

We note that presently Ameren's GSA provides that the service company can provide certain functions for its various affiliated entities that, if the Proposed Rules are adopted, it could no longer provide for its non-regulated affiliates – or if it were to, it must offer to other non-affiliated companies. Specifically, the current GSA provides that the service company will provide certain Corporate Planning, Customer Services/Division Support, Economic Development, Energy Supply, Engineering and Construction support, Environmental Services & Safety, Fossil Fuel Procurement, Gas Supply, Industrial Relations, Marketing, Real Estate, and Stores services. However, if these functions were carried out exclusively for the two public utility subsidiaries by the service company, they could continue to be provided by the service company without the need to provide them to the competitors of Ameren's affiliates. Under such a scenario, if the affiliated entities need or desire such above listed functions, it would have to develop these functions "in house" or procure them from outside vendors.

Additionally, if the Commission decides to accept OPC's recommendation regarding physical separation requirements, then the services company personnel carrying out the activities listed in the preceding paragraph would have to be physically separated from, and not in communications

with, the non-regulated affiliates (and any service corporation activities performed for the non-regulated affiliates). If Ameren wanted to provide some of the GSA services listed above to its affiliates, then it would also need to make these services available to the competitors of its non-regulated affiliates unless these services fit into the "no unfair advantage" category or OPC's "corporate support functions" category.

The OPC submits that any required changes to Ameren's GSA should be relatively insignificant. Finally, if the OPC has underestimated the impact of the Proposed Rules upon Ameren's GSA or organization, we note that the Proposed Rules do provide for "variances" where appropriate. In short and in sum, with a corporate support function exception, the OPC believes that Ameren's GSA and the Proposed Rules are not significantly in conflict.

Development of a Cost Allocation Manual for Utilities Electing to Offer Competitive Business Lines Is Necessary and Appropriate.

Some utility respondents have suggested that a Cost Allocation Manual ("CAM") would be complex to develop, controversial in adoption and costly to maintain and regulate (See Missouri Utilities Initial Comments in Case No. GX-99-444, p. 4). The OPC submits that adoption of concepts to be incorporated within a CAM is controversial – and indeed, involves some of the major controversies in Case Nos. EX-99-442 and GX-99-444. However, once the *concepts* being determined within these *controversial* cases are established, the OPC believes the actual development of a CAM will be fairly straightforward and non-controversial.

Missouri Utilities complains that "the Proposed Rules do not specify the level of detail that would have to be included in such a manual or how complex the proceedings required to consider and approve the manual would be." (See Initial Comments, Case No. GX-99-444, pp. 15-16). Under the Proposed Rules, the CAM must develop a fully distributed cost amount, and for goods and services not "exempted," a fair market value amount. The concept of "fully distributed costs" is defined in the rule and is not unique or novel in the industry. Basically

under FDC every cost incurred by an entity must be assigned or allocated to some entity. The overriding principles of FDC dictate that:

1. To the greatest extent possible, costs should be directly assigned to the entity and/or business line benefiting from the good or service.
2. Homogenous cost groups should be allocated utilizing the best, or most appropriate, factors that consider the "causative" nature of cost incurred.
3. Any remaining costs should be allocated utilizing composite allocation factors that typically include investment, revenues and expense levels of all the various entities in the corporate group.

The OPC submits that if the various utilities undertake a sincere and diligent effort to adhere to these guidelines, and also suggest legitimate and recognized sources for market prices to be utilized in arriving at a "fair market value," that the CAM filings and proceedings will not be nearly so controversial as some utilities have implied within their Initial Comments.

The OPC would agree that each utility could expend fairly significant resources in the first edition of its CAM. However, the annual update and review process – other than if the utility or its affiliate roll-out a significant new non-regulated business line – can be expected to be fairly routine without significant additional resources being required. Just as a utility can often go for years without significantly modifying its general accounting manual, OPC would expect that the updating of a CAM would, likewise, be a fairly routine and insignificant undertaking.

The OPC also notes that the recently-approved NARUC Guidelines for Cost Allocations and Affiliate Transactions (see Attachment 2) also support the creation of a CAM. In relevant part the NARUC guideline state "[e]ach entity that provides both regulated and non-regulated services or products should maintain a cost allocation manual (CAM) or its equivalent and notify the jurisdictional regulatory authorities of the CAM's existence." Without an up to date CAM, the ability to monitor compliance with the Proposed Rules will be exceedingly difficult. Along these lines, the OPC notes that the NARUC Guidelines go on to recommend and discuss "Audit Requirements" related to affiliate transactions:

> An audit trail should exist with respect to all transactions between the regulated entity and its affiliates that relate to regulated services and products. The regulator should have

complete access to all affiliate records necessary to ensure that cost allocations and affiliate transactions are conducted in accordance with the guidelines. Regulators should have complete access to affiliate records, consistent with state statues, to ensure that the regulator has access to all relevant information necessary to evaluate whether subsidization exists. The auditors, not the audited utilities, should determine what information is relevant for a particular objective. Limitations on access would compromise the audit process and impaired independence.

United Cities Gas Company and Greeley Gas Company recommend that if a given CAM is "accepted" by the Commission, that the allocations contained in them should be deemed "accepted" for ratemaking purposes. OPC objects to this utility proposal -- a mere "acceptance" of a utility's filing of a CAM should not be deemed to be "approval" of such document for ratemaking purposes. This position is consistent with a number of other Missouri Commission precedents. For instance, when approving Electric Utility Resource Planning rules, the Commission specifically stated:

> Based on the comments and the public hearing, the commission determines that certain amendments to section (2) are warranted. The commission does not believe that it is either appropriate or arguably even lawful for it to engage in ratemaking in a rulemaking proceeding. Thus, the commission declines to add any proposed language regarding "future rate recovery," "prudently incurred costs," "used and useful," or "fully operational and used for service," and deletes presently included language regarding "fixing rates" and "reasonable or prudent expenditures." These matters should more appropriately be dealt with in a non-rulemaking proceeding. Although the commission may authorize a utility to take the specific action for which the utility has requested commission authorization, it has been the general approach or policy of the commission to decline to make a ratemaking determination outside the context of a rate case. Typically, the commission states, in an "ORDERED" section of the order authorizing the specific action, that nothing in the order should be considered as a finding by the commission of the reasonableness of the expenditures involved, nor as an acquiescence in the value of the properties, and the commission reserves the right to consider the ratemaking treatment to be afforded the expenditures, and their resulting cost of capital, in a later proceeding. (4 CSR 240-22 Order of Rulemaking, page 53.)

In addition, the OPC notes that this Commission occasionally issues an accounting authority order – with the explicit instructions that such order does not necessarily mandate future ratemaking treatment.

Furthermore, the Commission requires utilities to keep their books and records in compliance with the FERC Uniform System of Accounts. However, such record keeping requirement in no

way dictates or mandates ratemaking requirements. In fact, Section (4) of 4 CSR 240-40.040 Uniform System of Accounts - Gas Corporation specifically states:

> In prescribing this system of accounts the commission does not commit itself to the approval or acceptance of any item set out in any account, for purposes of fixing rates or in determining other matters before the commission.

Similar language that applies to electric utilities can be found in section (4) of 4 CSR 240-20.

In response to the ratemaking treatment recommendation made by United Cities Gas Company and Greeley Gas Company, Public Counsel recommends adding the following language to the standards section of the Proposed Rules:

(H) In prescribing these standards the commission does not commit itself to the approval or acceptance of any transactions, transfers or assignments for purposes of fixing rates or in determining other matters before the commission.

The addition of this language would eliminate any uncertainty regarding the ratemaking implications of the rule and would be consistent with the Commission's policy of declining to make ratemaking determinations outside the context of a rate case

Finally, the OPC would note its surprise at certain utilities' suggestion that compliance with CAM guidelines should confer ratemaking approval of such transactions. Indeed, the utilities themselves may, on occasion, want to recommend a different ratemaking outcome than what the CAM standards might otherwise dictate. All parties will no doubt look to the Rules and compliance with a CAM for assurance that subsidization of affiliate interests is not occurring. Nonetheless, it would seem that all parties would also like the flexibility to offer or suggest a different ratemaking treatment than what has been recorded pursuant to a CAM.

In short and in sum, the Commission should not be dissuaded by the utilities' cry of "burden" and "controversy." OPC submits that adoption of a CAM is a necessary undertaking that is required to help facilitate compliance with the affiliate transaction rules. Furthermore, "acceptance" of a CAM should not denote "ratemaking approval" of any transaction recorded in compliance with an "accepted" CAM.

Public Counsel Response to Legal Issues Raised in Initial Comments

a.) Jurisdiction

Some of the utilities filing Initial Comments in this case, including MGE (at p. 4) and KCPL (at p. 3) argue that the proposed rule violates § 393.140(12) RSMo 1994. They argue that the rule goes beyond the statutory authority granted to the Commission by the Missouri General Assembly, and that the Commission does not have jurisdiction to promulgate the rule.

The portion of § 393.140(12) RSMo 1994 cited by the utilities provides as follows:

> In case any electrical corporation...engaged in carrying on any other business than owning, operating or managing a[n]...electric plant...which other business is not otherwise subject to the jurisdiction of the commission, and is so conducted that its operations are to be substantially kept separate and apart from the owning, operating, managing or controlling of such...electric plant..., said corporation in respect to other business shall not be subject to any of the provisions of this chapter and shall not be required to procure the consent or authorization of the commission to any act in such other business or to make any report in respect thereof.

The very next sentence in that section, not mentioned by any of the utilities, reads:

> But this subdivision shall not restrict or limit the powers of the commission in respect to the owning, operating, managing or controlling by such corporation of such...electric plant,...and said powers shall include also the right to inquire as to, and prescribe the apportionment of, capitalization, earnings, debts and expenses fairly and justly to be awarded to or borne by the ownership, operation, management or control of such...electric plant,...as distinguished from such other business [emphasis added].

This statute, when read as a whole, does grant the Commission the jurisdiction to oversee the allocation of revenues, expenses and investment among a utility's regulated and unregulated businesses.

Further, the Commission is required under § 393.140(5) RSMo 1994 to "examine all persons and corporations under its supervision and keep informed as to the methods, practices, regulations and property employed by them in the transaction of their business."

Additionally, Public Counsel concurs with the conclusions reached by the Staff (at pp. 1-7 of its Initial Comments) regarding the Commission's jurisdiction in these matters, and encourages the Commission to review Staff's thorough discussion of the relevant Missouri case law on affiliated transactions.

KCPL, at p. 3 in its Initial Comments herein, speaks of a "long line of Missouri case law that reiterates the statutory prohibition" [keeping the Commission from regulating "non-jurisdictional businesses"], but cites only one, Associated Natural Gas Co. v. Public Service Commission of Missouri, 706 S.W.2d 870 (Mo. App. 1985). The citation to this case contained in KCPL's Comments, however, refers to a part of the opinion in which the court is merely repeating the arguments presented by the Associated Natural Gas Company in that case.

The holding in Associated Natural Gas not only does not support KCPL's position that the Commission lacks jurisdiction, but in fact it specifically rejects that position, stating that the "argument and the proposed statutory interpretation are without citation of authority and are not well taken" Ibid at 880. The Court then cites § 393.140(12) RSMo 1994, *supra,* and adopts the statutory interpretation presented by Staff and Public Counsel herein. Clearly, the Commission has the authority to promulgate an affiliated transactions rule.

b.) Constitutional Concerns of Ameren Corporation

Ameren argues on p. 26 of its Initial Comments in this case that "Section 2(D) [of the proposed rule] also suffers a constitutional problem [in that] the proposed regulation would compel the utility to send a message (*i.e.*, an implied warranty of competitors' services) with which it may not agree and to associate with entities (*i.e.*, competitors) to whom it certainly is adverse.

Ameren goes on to say that the "First Amendment of the United States Constitution and the free speech protections of the Missouri Constitution protect against such dangers and, accordingly, render the proposed regulations unconstitutional."

OPC does not believe that the rule suffers from any such constitutional problem. The U.S. Supreme Court has long recognized that the Constitution provides significantly fewer protections for commercial speech than for private speech. *See* Central Hudson Gas & Electric Corp. v. Public Service Commission of New York, 447 U.S. 557, 562 (1980), citing Ohralik v. Ohio State Bar Association, 436 U.S. 447, 455-456 (1978), et. al.

However, if the Commission perceives that there is a First Amendment problem with requiring utilities to provide inquiring customers with information regarding the availability of other nonaffiliated entities that provide the same goods or services (*i.e.,* names of competitors), rather than reject the rule entirely because of any uncertainty, Public Counsel would suggest that the Commission consider adopting the alternate approach taken in the recommended rule (at Section 2(B)(2)) attached to OPC's Initial Comments.

Public Counsel's recommended rule would not require a utility to disclose information regarding competitors who provide the same goods or services, but, in the event a customer requested information about goods or services provided by the utility's affiliate, the utility would be required to direct the customer to a generally available listing of service providers (e.g., the Yellow Pages). This approach should eliminate any perceived First Amendment problems since it would not mandate any speech or association.

The recommended rule includes a provision prohibiting a utility from advertising its affiliated entity's affiliation with the utility without making certain simultaneous disclosures. This provision would restrict the use of the utility's name and logo absent the required disclosures, but would not create a First Amendment issue, for the reasons set forth below.

In the Central Hudson Gas & Electric case, *supra* at 563, the Court states that "commercial speech, the offspring of economic self-interest, is a hardy breed of expression that is not

'particularly susceptible to being crushed by overbroad regulation.'" The Court recognizes that commercial speech may be restricted under certain conditions, especially when the speech is that of a regulated business.

Additionally, the Court has held that "the government may ban forms of communication more likely to deceive the public than to inform it." Friedman v. Roger, 440 U.S. 1, 11 (1979); Ohralik at 563. The advertising of an affiliation with a utility could create confusion in the minds of consumers who may be attracted by a trade name or logo that reflects the reputation of the utility, which actually has nothing to do with the affiliate (unless the utility is cross-subsidizing the affiliate).

Conclusion

The Commission's Proposed Rules are generally reasonable and in the public interest as proposed. Public Counsel believes that the modifications to the Proposed Rules that we have suggested in our Initial and Reply Comments would (1) make the rules easier to implement by clarifying the requirements contained in the rules and (2) cause the affiliate rules for electric and gas utilities to become a better vehicle for fulfilling the goals that this Commission has for preventing cross subsidies and discriminatory practices.

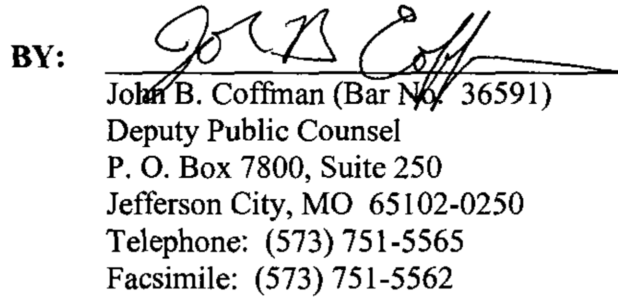
Public Counsel encourages this Commission to ignore the comments made by utilities that fit within the themes of "it ain't broke so don't fix it" and "these rules will harm rather that benefit consumers." These comments must generally be interpreted for what they are – the utilities' efforts to minimize the protection of ratepayers and the protection of effective competition where these protections jeopardize the future profit potential of unregulated activities There is nothing sinister about these efforts – they are simply a part of the fiduciary duty that utilities have for protecting the interests of their shareholders.

The additional rule provisions and modified rule provisions that OPC has proposed or suggested consideration of in these Reply Comments are listed in Appendix 3.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

BY:



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Resolution Regarding Cost Allocation Guidelines for the Energy Industry

WHEREAS, There is ongoing concern regarding potential cross-subsidization between the regulated monopoly operations and the non-regulated businesses of electric and gas utilities; and

WHEREAS, Utilities are adopting various business strategies to adjust to the changing retail markets, including forming alliances and creating subsidiaries, divisions and partnerships to participate in non-regulated, competitive markets; and

WHEREAS, State utility commissions are examining and adopting various policies to monitor the competitive activities of regulated energy utilities; and

WHEREAS, State utility commissions are examining and adopting policies and rules concerning potential cross-subsidies between regulated utilities and non-regulated affiliates including pricing of assets, products and services; and

WHEREAS, The National Association of Regulatory Utility Commissioners (NARUC) requested the Staff Subcommittee on Accounts together with the Staff Subcommittees on Strategic Issues and Gas to prepare for NARUC's consideration, "Guidelines for Energy Cost Allocations"; and

WHEREAS, The Staff Subcommittee on Accounts together with the Subcommittee on Gas and Strategic Issues have prepared for NARUC's consideration "Guidelines for Cost Allocations and Affiliate Transactions"; and

WHEREAS, Each State or Federal Regulatory commission may have unique situations and circumstances that govern affiliate transactions, cost allocations, and/or service or product pricing; and

Attachment 1
Pages 1-2

WHEREAS, The "Guidelines for Cost Allocations and Affiliate Transactions" are to provide guidance to the states and are not intended to be rules or regulations prescribing how cost allocations and affiliate transactions are to be handled; and

WHEREAS, The Staff Subcommittees on Accounts, Strategic Issues and Gas should periodically review the Guidelines for Cost Allocations and Affiliate Transactions, taking into consideration the progression of competition in the electric and gas industries nationally, and report their findings, including proposed changes to the guidelines, if necessary, that promote efficiency in competitive energy markets while guarding against cross-subsidization by monopoly ratepayers; now therefore be it

RESOLVED, The Board of Directors of the of the National Association of Regulatory Utility Commissioners (NARUC), convened in its 1999 Summer Meeting in San Francisco, California, adopts the attached "Guidelines for Cost Allocations and Affiliate Transactions"; and be it further

RESOLVED, The NARUC directs the Staff Subcommittees on Accounts, Strategic Issues and Gas, to review the Guidelines for Cost Allocation and Affiliate Transactions, taking into consideration the progression of competition in the electric and gas industries nationally and report their findings to NARUC, including proposed changes to the guidelines, if necessary, on or before January 1, 2001, and annually thereafter, and be it further

RESOLVED, The NARUC applauds and thanks the Staff Subcommittees on Accounts, Gas, and Strategic Issues for their excellent work in developing the guidelines.

Sponsored by the Committees on Electricity and Finance and Technology

Adopted by the NARUC Board of Directors July 23, 1999

GUIDELINES FOR COST ALLOCATIONS AND AFFILIATE TRANSACTIONS

The following Guidelines for Cost Allocations and Affiliate Transactions (Guidelines) are intended to provide guidance to jurisdictional regulatory authorities and regulated utilities and their affiliates in the development of procedures and recording of transactions for services and products between a regulated entity and affiliates. The prevailing premise of these Guidelines is that allocation methods should not result in subsidization of non-regulated services or products by regulated entities unless authorized by the jurisdictional regulatory authority. These Guidelines are not intended to be rules or regulations prescribing how cost allocations and affiliate transactions are to be handled. They are intended to provide a framework for regulated entities and regulatory authorities in the development of their own policies and procedures for cost allocations and affiliated transactions. Variation in regulatory environment may justify different cost allocation methods than those embodied in the Guidelines.

The Guidelines acknowledge and reference the use of several different practices and methods. It is intended that there be latitude in the application of these guidelines, subject to regulatory oversight. The implementation and compliance with these cost allocations and affiliate transaction guidelines, by regulated utilities under the authority of jurisdictional regulatory commissions, is subject to Federal and state law. Each state or Federal regulatory commission may have unique situations and circumstances that govern affiliate transactions, cost allocations, and/or service or product pricing standards. For example, The Public Utility Holding Company Act of 1935 requires registered holding company systems to price "at cost" the sale of goods and services and the undertaking of construction contracts between affiliate companies.

The Guidelines were developed by the NARUC Staff Subcommittee on Accounts in compliance with the Resolution passed on March 3, 1998 entitled "Resolution Regarding Cost Allocation for the Energy Industry" which directed the Staff Subcommittee on Accounts together with the Staff Subcommittees on Strategic Issues and Gas to prepare for NARUC's consideration, "Guidelines for Energy Cost Allocations." In addition, input was requested from other industry parties. Various levels of input were obtained in the development of the Guidelines from the Edison Electric Institute, American Gas Association, Securities and Exchange Commission, the Federal Energy Regulatory Commission, Rural Utilities Service

Attachment 2
Pages 1-7

and the National Rural Electric Cooperatives Association as well as staff of various state public utility commissions.

In some instances, non-structural safeguards as contained in these guidelines may not be sufficient to prevent market power problems in strategic markets such as the generation market. Problems arise when a firm has the ability to raise prices above market for a sustained period and/or impede output of a product or service. Such concerns have led some states to develop codes of conduct to govern relationships between the regulated utility and its non-regulated affiliates. Consideration should be given to any "unique" advantages an incumbent utility would have over competitors in an emerging market such as the retail energy market. A code of conduct should be used in conjunction with guidelines on cost allocations and affiliate transactions.

A. DEFINITIONS

1. Affiliates - companies that are related to each other due to common ownership or control.

2. Attestation Engagement - one in which a certified public accountant who is in the practice of public accounting is contracted to issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party.

3. Cost Allocation Manual (CAM) - an indexed compilation and documentation of a company's cost allocation policies and related procedures.

4. Cost Allocations - the methods or ratios used to apportion costs. A cost allocator can be based on the origin of costs, as in the case of cost drivers; cost-causative linkage of an indirect nature; or one or more overall factors (also known as general allocators).

5. Common Costs - costs associated with services or products that are of joint benefit between regulated and non-regulated business units.

6. Cost Driver - a measurable event or quantity which influences the level of costs incurred and which can be directly traced to the origin of the costs themselves.

7. Direct Costs - costs which can be specifically identified with a particular service or product.

8. Fully Allocated costs - the sum of the direct costs plus an appropriate share of indirect costs.

9. Incremental pricing - pricing services or products on a basis of only the additional costs added by their operations while one or more pre-existing services or products support the fixed costs.

10. Indirect Costs - costs that cannot be identified with a particular service or product. This includes but not limited to overhead costs, administrative and general, and taxes.

11. Non-regulated – that which is not subject to regulation by regulatory authorities.

12. Prevailing Market Pricing - a generally accepted market value that can be substantiated by clearly comparable transactions, auction or appraisal.

13. Regulated – that which is subject to regulation by regulatory authorities.

14. Subsidization - the recovery of costs from one class of customers or business unit that are attributable to another.

B. COST ALLOCATION PRINCIPLES

The following allocation principles should be used whenever products or services are provided between a regulated utility and its non-regulated affiliate or division.

1. To the maximum extent practicable, in consideration of administrative costs, costs should be collected and classified on a direct basis for each asset, service or product provided.

2. The general method for charging indirect costs should be on a fully allocated cost basis. Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates.

3. To the extent possible, all direct and allocated costs between regulated and non-regulated services and products should be traceable on the books of the applicable regulated utility to the applicable Uniform System of Accounts. Documentation should be made available to the appropriate regulatory

authority upon request regarding transactions between the regulated utility and its affiliates.

4. The allocation methods should apply to the regulated entity's affiliates in order to prevent subsidization from, and ensure equitable cost sharing among the regulated entity and its affiliates, and vice versa.

5. All costs should be classified to services or products which, by their very nature, are either regulated, non-regulated, or common to both.

6. The primary cost driver of common costs, or a relevant proxy in the absence of a primary cost driver, should be identified and used to allocate the cost between regulated and non-regulated services or products.

7. The indirect costs of each business unit, including the allocated costs of shared services, should be spread to the services or products to which they relate using relevant cost allocators.

C. COST ALLOCATION MANUAL (NOT TARIFFED)

Each entity that provides both regulated and non-regulated services or products should maintain a cost allocation manual (CAM) or its equivalent and notify the jurisdictional regulatory authorities of the CAM's existence. The determination of what, if any, information should be held confidential should be based on the statutes and rules of the regulatory agency that requires the information. Any entity required to provide notification of a CAM(s) should make arrangements as necessary and appropriate to ensure competitively sensitive information derived therefrom be kept confidential by the regulator. At a minimum, the CAM should contain the following:

1. An organization chart of the holding company, depicting all affiliates, and regulated entities.

2. A description of all assets, services and products provided to and from the regulated entity and each of its affiliates.

3. A description of all assets, services and products provided by the regulated entity to non-affiliates.

4. A description of the cost allocators and methods used by the regulated entity and the cost allocators and methods used by its affiliates related to the regulated services and products provided to the regulated entity.

D. AFFILIATE TRANSACTIONS (NOT TARIFFED)

The affiliate transactions pricing guidelines are based on two assumptions. First, affiliate transactions raise the concern of self-dealing where market forces do not necessarily drive prices. Second, utilities have a natural business incentive to shift costs from non-regulated competitive operations to regulated monopoly operations since recovery is more certain with captive ratepayers. Too much flexibility will lead to subsidization. However, if the affiliate transaction pricing guidelines are too rigid, economic transactions may be discouraged.

The objective of the affiliate transactions' guidelines is to lessen the possibility of subsidization in order to protect monopoly ratepayers and to help establish and preserve competition in the electric generation and the electric and gas supply markets. It provides ample flexibility to accommodate exceptions where the outcome is in the best interest of the utility, its ratepayers and competition. As with any transactions, the burden of proof for any exception from the general rule rests with the proponent of the exception.

1. Generally, the price for services, products and the use of assets provided by a regulated entity to its non-regulated affiliates should be at the higher of fully allocated costs or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.

2. Generally, the price for services, products and the use of assets provided by a non-regulated affiliate to a regulated affiliate should be at the lower of fully allocated cost or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.

3. Generally, transfer of a capital asset from the utility to its non-regulated affiliate should be at the greater of prevailing market price or net book value, except as otherwise required by law or regulation. Generally, transfer of assets from an affiliate to the utility should be at the lower of prevailing market price or net book value, except as otherwise required by law or regulation. To determine prevailing market value, an appraisal should be required at certain value thresholds as determined by regulators.

4. Entities should maintain all information underlying affiliate transactions with the affiliated utility for a minimum of three years, or as required by law or regulation.

E. AUDIT REQUIREMENTS

1. An audit trail should exist with respect to all transactions between the regulated entity and its affiliates that relate to regulated services and products. The regulator should have complete access to all affiliate records necessary to ensure that cost allocations and affiliate transactions are conducted in accordance with the guidelines. Regulators should have complete access to affiliate records, consistent with state statutes, to ensure that the regulator has access to all relevant information necessary to evaluate whether subsidization exists. The auditors, not the audited utilities, should determine what information is relevant for a particular audit objective. Limitations on access would compromise the audit process and impair audit independence.

2. Each regulated entity's cost allocation documentation should be made available to the company's internal auditors for periodic review of the allocation policy and process and to any jurisdictional regulatory authority when appropriate and upon request.

3. Any jurisdictional regulatory authority may request an independent attestation engagement of the CAM. The cost of any independent attestation engagement associated with the CAM, should be shared between regulated and non-regulated operations consistent with the allocation of similar common costs.

4. Any audit of the CAM should not otherwise limit or restrict the authority of state regulatory authorities to have access to the books and records of and audit the operations of jurisdictional utilities.

5. Any entity required to provide access to its books and records should make arrangements as necessary and appropriate to ensure that competitively sensitive information derived therefrom be kept confidential by the regulator.

F. REPORTING REQUIREMENTS

1. The regulated entity should report annually the dollar amount of non-tariffed transactions associated with the provision of each service or product and the use or sale of each asset for the following:

   a. Those provided to each non-regulated affiliate.

   b. Those received from each non-regulated affiliate.

   c. Those provided to non-affiliated entities.

2. Any additional information needed to assure compliance with these Guidelines, such as cost of service data necessary to evaluate subsidization issues, should be provided.

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SUMMARY OF NEW RULE LANGUAGE IN OPC'S REPLY COMMENTS

Additions and modifications to the Standards sections of the OPC's Proposed Rules

(A) Except as necessary to provide corporate support functions, *a regulated gas/electric corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated gas/electric corporation shall be deemed to provide a financial advantage to an affiliated entity if* – (Underlined portion represents OPC's suggested change. Remaining portion of this "Standards" section remains as original version)

(F) Corporate support functions shall be assigned to all affiliated entities by the utility or any service corporation providing such corporate support functions to the utility and its affiliated entities utilizing a fully distributed cost methodology.

(G) A regulated electric/gas corporation shall be deemed to have provided no preferential service or any financial advantage to an affiliated entity so long as it has complied with all other Nondiscrimination Standards of Conduct for Affiliated Entities and other Standards as set forth in Sections (2) and (3) of 4 CSR 240-20.015 / 4 CSR 240.40.015. (Please note – the addition of this subsection would only be appropriate if the Commission decides to include OPC's proposed section (2), Nondiscrimination Standards of Conduct for Affiliated Entities, as it appeared in our Initial Comments in Case Nos. EX-99-442 and GX-99-444)

(H) In prescribing these standards the commission does not commit itself to the approval or acceptance of any transactions, transfers or assignments for purposes of fixing rates or in determining other matters before the commission.

Language to be added to the end of the Preferential Service definition in the Proposed Rules

A utility's affiliate gains an unfair advantage over its competitors when a regulated utility provides resources to its affiliated entity that were acquired through the provision of regulated utility service where such resources cannot be either obtained or replicated internally by the affiliate's competitors in a reasonable amount of time and for a cost that is similar to the price that the utility charges its affiliate for the same resource (Please note – OPC does not believe this additional language would be necessary if the Commission decides to include the above section (G) as well as OPC's proposed section (2), Nondiscrimination Standards of Conduct for Affiliated Entities, as it appeared in our Initial Comments in Case Nos. EX-99-442 and GX-99-444)