

MEMORANDUM

TO: Missouri Public Service Commission
Official Case File, Case No. AO-2018-0179

FROM: Mark L. Oligschlaeger, Manager, Auditing Department
Kimberly K. Bolin, Auditor V

/s/ Natelle Dietrich 5/31/2018
Case Coordinator / Date

/s/ Mark Johnson 5/31/2018
Staff Counsel's Office / Date

SUBJECT: Staff Recommendation for the **Rejection** of the Application of The Empire District Electric Company, The Empire District Gas Company, Liberty Utilities (Midstates Natural Gas) Corp., and Liberty Utilities (Missouri Water) LLC for an Affiliate Transactions Rule Variance

DATE: May 31, 2018

On December 29, 2017, The Empire District Electric Company ("Empire Electric"), The Empire District Gas Company ("Empire Gas"), Liberty Utilities (Midstates Natural Gas) Corp. ("Liberty Gas"), and Liberty Utilities (Missouri Water) LLC ("Liberty Water") (collectively "Applicants") filed an Application for Variance ("Application") requesting variances from the Commission's electric and gas Affiliate Transactions Rules ("Rules").¹ On January 29, 2018, the Applicants filed Exhibit A to Application. Exhibit A is a Money Pool Agreement ("Money Pool"). The Applicants request the variances in order to allow them to participate in a Money Pool,² administered by Liberty Utilities Co. ("LUCo"), which will result in affiliate transactions involving the Applicants and other affiliates of the Applicants.³ Staff recommends that the Commission deny the Application because it lacks an adequate or acceptable explanation as to why the proposed Money Pool must be structured and operated in a manner inconsistent with the existing Rules. In the event the Applicants enter into the Money Pool, Staff's recommendations regarding the Applicant's requested waiver of Commission Rules in this proceeding are not intended in any way to preclude the Staff from challenging or the Commission deciding issues in future rate proceedings regarding the operation of the money pool on ratemaking or prudence determinations concerning the financial impact of the Applicants' involvement in the Money Pool. Those issues may be raised in subsequent proceedings based on actual transactions.

¹ 4 CSR 240-20.015(2)(A) and 4 CSR 240-20.015(3)(A), and 4 CSR 240-40.015(2)(A) and 4 CSR 240-40.015(3)(A).

² The Application For Variance defines "Money Pool" in paragraph 16 as "a cash management arrangement among utilities, under which a utility may make short-term loans (less than 365 days) to other affiliates when they have excess cash, and may make short-term borrowings from other affiliates when they have short-term cash needs. Excess funds will also be invested in short-term high-quality liquid investments (such as money market funds) after borrowing participant needs have been met. LUCo is the administrator of the Money Pool and guarantees all loans by eligible borrowers. . . ." The Applicants are affiliates and subsidiaries of LUCo and LUCo is a subsidiary of Algonquin Power & Utilities Corp. ("Algonquin"). LUCo uses Liberty Utilities Service Corp. employees; LUCo has no employees of its own.

³ Staff understands that the Applicants are not seeking approval from the Commission regarding the decision to enter into the Money Pool as part of this Application.

Rationale for Staff Recommendation to Deny

The Money Pool Agreement contains an “Illinois Rider to Money Pool Agreement” which states in part in its second paragraph on page 1 that “[i]n order to ensure compliance by Liberty Midstates [“Midstates Natural Gas”] with Illinois Public Utilities Act and the applicable rules and regulations of the Illinois Commerce Commission, the Parties set forth certain additional terms and conditions applicable to Liberty Midstates’ participation in the Money Pool and its transactions with affiliates . . .” However, the Applicants’ requested variances from the Missouri Affiliate Transactions Rules are not consistent with the requirements contained within the Illinois Rider and the Applicants are not requesting to have the requirements of the Illinois Rider applied to the Applicants operating in Missouri. If the terms and conditions contained within the Illinois Rider are applied to the Application for purposes of Missouri regulation, it appears that there is no need for variances from the Commission’s existing Rules. This matter will be discussed further in the Illinois Rider section and elsewhere in this Staff Recommendation.

The Commission’s Rule 4 CSR 240-2.060(4) specifies that a filing for a variance or waiver must include:

(4) In addition to the requirements of section (1), applications for variances or waivers from commission rules and tariff provisions, as well as those statutory provisions which may be waived, shall contain information as follows:

- (A) Specific indication of the statute, rule, or tariff from which the variance or waiver is sought;
- (B) The reasons for the proposed variance or waiver and a complete justification setting out the good cause for granting the variance or waiver; and
- (C) The name of any public utility affected by the variance or waiver.⁴

Staff’s analysis identified the rationales given for the Applicants’ participation in the Money Pool, the provisions of the Rules cited for variances, and the relationship between the Rules’ variances with the benefits that will purportedly result from the variances. Staff’s recommendation is based in part on the fact the Applicants have not shown “good cause” to support their variance requests. The Rules sections that are the subject of the variance requests are intended to protect Missouri utility customers and are consistent with the Rules’ purpose to assure that customer rates are not adversely impacted by utility affiliated transaction activities. If the Applicants’ variance requests are granted, those protections would be reduced. For example, the elimination of the Rules’ competitive bidding requirement is inconsistent with the Rules’ purpose, and the Applicants have provided no assurance that participation in the Money Pool would not adversely impact Missouri utility customers’ rates.

In fact, the requested variances may result in transactions that increase the Missouri electric and gas utilities’ cost to provide service. If the Money Pool does not produce the lowest cost for borrowing short term funds compared to market alternatives and overstates the

⁴ A variance also may be sought by 4 CSR 240-20.015(10)(A)2 and 4 CSR 240-40.015(10)(A)2 but neither proposed variance by the Applicants meets the standard of being in the best interests of the utilities’ regulated customers.

investment income opportunities associated with higher risk loans, this will result in higher costs for the utilities.

Background Information

The Applicants are all utilities regulated by the Missouri Public Service Commission, and are subsidiaries of the same holding company, Liberty Utilities Co. (“LUCo”). LUCo, in turn, is owned by Algonquin Power & Utilities Corporation (“Algonquin”). Utilities operating in other jurisdictions, as well as a number of non-regulated ventures, are also part of the LUCo/Algonquin corporate structure.

This Application concerns a proposed cash management arrangement involving regulated and non-regulated affiliated entities of the Applicants. A money pool is a cash management approach that allows participants needing cash a vehicle to access short-term loans, and allows participants with excess cash a vehicle to invest the funds in interest-bearing instruments on a short-term basis. Both short-term borrowing and short-term investing activities are normal cash management activities for regulated utilities, and many options for these services are available from non-affiliated vendors.

In general, the Applicants claim that the cost of short-term borrowing through the Money Pool should be less than what is available from other alternatives, and that the interest earned on short-term investments made through the Money Pool should be greater than that available from other alternatives. However, there is no guarantee that the Money Pool will always be the most economical option for participants’ short-term borrowing or short-term investment needs.

Requested Financial Advantage Standard Variance Analysis

The Applicants have requested two variances from the Commission’s Affiliate Transactions Rules. The first is a variance from the Rules’ standards for determining whether a financial advantage has been provided to an affiliate; section (2)(A) of the Rules, 4 CSR 240-20.015(2)(A) and 4 CSR 240-40.015(2)(A). These sections state that, for purposes of the Rules, a regulated electrical or gas corporation shall be deemed to provide a financial advantage to an affiliated entity in one of two ways:

- 1) If the utility compensates an affiliate at the higher of fair market price or the fully distributed cost for the utility to acquire the good or service for itself; and
- 2) If the utility transfers information, assets, goods, or services of any kind to an affiliate below the greater of fair market price or the fully distributed cost to the utility.

The Applicants have failed to show that good cause exists that would justify a variance from these requirements. More importantly, there will be a detriment to the Applicants if they pay higher borrowing costs to LUCo than currently available through non-affiliate options, lend their money to non-regulated entities at below market interest rates relevant to their credit quality, or have their borrowing costs increased/investment income reduced by additional charges associated with the cost of administration of the Money Pool.

The Applicants are capable of providing for themselves procurement of short-term borrowing services and investment of excess cash separate and apart from participation in the Money Pool. As such, it is crucial that the comparison between the fully distributed cost (“FDC”) of the service to the Applicants and the fair market price (“FMP”) of the service take place to ensure that customers are not harmed as a result of uneconomic borrowing or investment arrangements made through the Money Pool.

The only argument the Applicants pose to justify this waiver is that the Applicants cannot obtain lower than FMP or FDC for services provided to them by affiliates while also gaining the greater of FMP or FDC for services they provide to affiliates. The Applicants claim the asymmetrical pricing requirements should not apply in transactions between two regulated affiliates. However, structurally, the Money Pool transactions will not involve two regulated entities; instead a regulated utility in an excess cash condition will provide the excess amount to the Money Pool, and a regulated utility needing to borrow money will obtain the funds from the Money Pool. The Money Pool is to be administered by LUCo, a non-regulated affiliate, and functionally all of the transactions will take place between one of the Applicants and LUCo. Transactions between regulated and non-regulated affiliates such as would be conducted through the Money Pool present an opportunity for inappropriate and uneconomic affiliated transactions, which the Rules, including the “asymmetric pricing” provisions, are designed to prevent.

The Application provides no explanation as to why the Money Pool’s benefits cannot be achieved if the Applicants compensate their affiliates for borrowed monies at the lower of fully distributed cost or fair market price, consistent with the Rules. The Application also does not explain why the Money Pool’s benefits cannot be achieved if the Applicants loan funds to their affiliates at the higher of fully distributed cost or fair market price, consistent with the Rules.

Requested Competitive Bidding Variance Analysis

The Applicants are also seeking a variance from the competitive bidding requirement of the Commission’s Affiliate Transactions Rules. This requirement is contained in Section (3)(A) of both the electric and gas Affiliate Transactions Rules, 4 CSR 240-20.015(3)(A) and 4 CSR 240-40.015(3)(A). The language in the electric Rule states:

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

The gas Rule has the same requirements. These standards require the utility to explore non-affiliate options for provision or procurement of goods and services so that affiliate transactions only occur when justified by comparison with non-affiliate alternatives. In addition, obtaining competitive bids when purchasing information, assets, goods or services from an affiliated entity, provides direct support for the determination of the “fair market price” element needed to ensure the utility is not providing a financial advantage to its affiliates.

The Application contains information regarding the benefits that purportedly will occur if the Applicants are allowed to participate in the Money Pool. However, the Application fails to explain why these benefits cannot be achieved if competitive bidding is undertaken for Money Pool activities in a manner consistent with the Rules.

Empire Electric has its own cash management program and currently borrows on better terms under its program than will be available through the Money Pool. Empire Electric has implemented a documented cash management program since at least July 2006. Its lower cost borrowing terms were acknowledged in paragraph 20 of the Application, where it was noted that, at the time of the filing of the Application, Empire Electric had its own commercial paper program, which was backed by its own \$200 million credit facility led by Wells Fargo. This credit facility was used to support the working capital needs of Empire Electric and Empire Gas and its funding rates were lower than those available under the Money Pool. Therefore, at the time of the filing of the Application Empire Electric and Empire Gas were only going to participate in the Money Pool as lenders of excess cash and were only going to borrow from the Money Pool if and when it offered a lower cost of funds. Staff agrees that this position is appropriate, but disagrees with the requested variances in that both the asymmetric pricing requirements and the competitive bidding requirements are necessary in order for Empire Electric and Empire Gas to assess the relative economics of utilizing the Money Pool for their short-term borrowing needs in the future.

In information provided to Staff in response to informal discovery concerning the Money Pool and Cost Allocation Manual matters on March 21, 2018, ** _____

_____*The Applicants have indicated that currently there is no plan to discontinue Empire's commercial paper program and Empire Electric's, Empire Gas's, and Empire District Industries' short-term cash needs will continue to be primarily funded via Empire's commercial paper program; i.e, outside of the Money Pool. (Responses to Staff Data Request Nos. 0017, 0021, and 0012 in File No. AO-2018-0179).

The Applicants reviewed several money pool agreements while developing the LUCo Money Pool Agreement, and these agreements were subsequently provided to Staff. All of these money pool agreements contain a provision that explicitly states that the participants can borrow directly from banks or other qualified financial institutions, or sell their own commercial paper, when better terms can be achieved.⁵ One of the Applicants operating in Illinois, Midstates Natural Gas, is prohibited under the Illinois Rider from borrowing from the Money Pool if it can borrow at lower costs directly from banks or other qualified financial institutions or sell its own commercial paper. (Illinois Rider Section 1.(c)) In order to satisfy this requirement under the Illinois Rider, Midstates Natural Gas would need market information of the type solicited under a competitive bid process to define its cash management options. However, in contrast to the

⁵ The Applicants reviewed the Ameren Corporation Utility Money Pool Agreement, Avangrid Virtual Money Pool Agreement, Black Hills Utility Money Pool Agreement, Exelon Money Pool Agreement, and National Grid USA Regulated Money Pool Agreement when formulating the LUCo Money Pool Agreement (Response to Staff Data Request 0015 in AO-2018-0179 and e-mail to Bob Schallenberg from Mark Timpe, April 12, 2018).

terms of other agreements, it is not clear as to whether the Applicants would retain the ability to borrow money when better terms are available from sources other than the Money Pool.

Fully Distributed Costs Definition Variance

Staff's analysis uncovered an additional Money Pool component that appears not to comply with the Rules and is not specifically addressed in the Application. By seeking a waiver of the asymmetric pricing provisions the Applicants are in effect also asking for a waiver from the Rules' required application of FDC pricing.

This comes into play in regard to the proposed treatment of the administrative costs of the Money Pool in the Money Pool Agreement. On page 9 of its March 21, 2018, response to Staff Money Pool and CAM questions, the Applicants stated: "Costs associated with operating the Money Pool will be allocated as described in the CAM." Staff interprets this statement to mean that the indirect and general costs to operate the Money Pool will be allocated to the LUCo entities based on the four (4) factor approach (utility net plant, customer count, non-labor expenses, and labor expenses). Allocation of indirect and general costs in this manner means that the Applicants will be required to bear a portion of the fixed costs of the Money Pool whether the Money Pool services are used by the Applicants or not.

Based upon data provided to Staff,⁶ approximately 42.0% of the costs to operate the Money Pool would be allocated to Empire Electric and Empire Gas, approximately 7.5% of the costs would be allocated to Midstates Natural Gas, and approximately 0.35% of the costs to operate the Money Pool would be allocated to Liberty Water. Thus, the Applicants will be charged approximately 50% of the fixed costs to operate the Money Pool whether the Applicants are lending to or borrowing from the Money Pool or not.

The Rules require the use of a FDC methodology for the determination of the cost of a good or service. FDC is defined in the Rules, in part, as "a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced." All enterprise costs must consider not only direct costs (e.g., line of credit borrowing fees) but include indirect assignable costs (e.g., legal costs) and general allocated costs (e.g., secretary of state fees). This methodology is conducted on the enterprise level (e.g., LUCo) to assure all goods and services are treated objectively. The proposed Money Pool is not structured to support a LUCo FDC methodology related to examination of LUCo's total costs associated with all the goods and services produced by LUCo, such as the instant Money Pool. Such an examination is needed to understand the true cost/benefit impact on each Applicant of participating in the Money Pool. It is a violation of the FDC pricing approach for the Applicants to pay any administrative costs associated with the Money Pool if the Applicants are not lending to or borrowing from the Money Pool, even if considered "eligible borrowers." The Applicants should take the fixed costs of the Money Pool into account before each decides whether the Money Pool is the best option to address its cash management needs. Section 2.01 Operation of Money Pool of the LUCo Money Pool Agreement states: "LUCo will administer the Money Pool on an 'at cost' basis." This

⁶ Invoices for affiliate transactions for Empire Electric, Empire Gas, Midstates Natural Gas, and Liberty Water for December 2017 were provided to Staff on flash drives as a sample month for calendar year 2017 by the Applicants on April 13, 2018. The invoices detail the allocation of indirect and general costs.

contract language is unclear in that it does not specifically state that “at cost” is intended to equal fully distributed cost.

The allocation of indirect and general Money Pool costs to affiliates who may not be currently using the services of the Money Pool is especially problematic when taking into account Empire’s current borrowing arrangement. As previously discussed, Empire currently meets its short-term borrowing needs through its own credit facility, and will not borrow funds through the Money Pool as long as its borrowing cost is less expensive than through the Money Pool. Notwithstanding that approach, the Money Pool Agreement calls for Empire to assume a major portion of responsibility for certain Money Pool fixed costs associated with its lending operations, even though it is currently uneconomical for Empire to utilize the Money Pool services for which the costs are incurred. Empire would be in the position of potentially paying a large portion of the costs for services it will not use, and as a result the actual users of that service would not be charged all of the costs of the service. This is the type of subsidy the Rules were intended to prevent.

Illinois Rider to Money Pool Agreement

The Illinois Rider is an attachment to the Money Pool Agreement that is intended to ensure that Liberty/Algonquin affiliates operating under the jurisdiction of the Illinois Commerce Commission (“ICC”) meet certain regulatory requirements imposed by Illinois statute and the ICC. The content of the Illinois Rider is considered by Staff to be consistent with the intent of the Missouri Commission’s Affiliate Transactions Rules. The requirement that Midstates Natural Gas cannot borrow from the Money Pool when it can borrow on better terms elsewhere (Section 1.(c)) is consistent with the Rules. The requirement that Midstates Natural Gas may only loan funds through the Money Pool when it cannot earn a higher return on investments of similar risks in the open market (Section 2.(d)) is also consistent with the Rule. Therefore, if the terms of the Illinois Rider are applied to the Applicants as they operate in Missouri, both the asymmetric pricing requirements and the competitive bidding requirements should be retained in order to allow the Applicants the means to choose the most economical options for their cash management needs.

In summary, agreement by the Applicants to comply with the provisions of the Illinois Rider for purposes of Missouri regulation would support the intent of the Rules to protect Missouri customers from potential harm due to entering into inappropriate affiliated transactions, and would obviate any need for the requested variances.

Other Concerns

At this time, Staff has two general concerns regarding the structure of the proposed Money Pool that are not directly related to the Applicants’ requests for variance but go to Staff’s general consideration of whether the Applicants’ proposal is reasonable.

The Applicants stated in March 21, 2018, responses to Staff Money Pool and CAM questions that both regulated and nonregulated affiliates should be included in the Money Pool because the relative size of the nonregulated entities based on revenues, gross plant, and customers is an indication of their low potential risk level. It is Staff’s opinion that the

actual risk level associated with participation of non-regulated entities in the Money Pool is in part the lack of limits on the amount of money these entities can borrow as well as the additional risk that can be added to the Money Pool by these borrowers under Money Pool Agreement Section 3.03. Other money pools addressed this risk by limiting participation to regulated utilities and/or by imposing sublimits on the allowed borrowing capacity of each participant.⁷

Staff's second concern is in regard to the "LUCo guarantee." This term refers to Section 1.03 of the Money Pool Agreement, wherein it states that LUCo will guarantee the repayment of all Borrowings by an Eligible Borrower from the Money Pool. Under the LUCo guarantee provision, if an Eligible Borrower is unable or unwilling to repay a loan, LUCo shall contribute sufficient funds to the Money Pool to meet any outstanding repayment obligations. The LUCo guarantee is inherently risky because LUCo has no independent cash flow or assets to support its guarantee. A Money Pool loss would have to be covered or supported by the LUCo owned utilities' cash flow and assets, including Missouri utilities. The Applicants represent a large portion of LUCo's utility business and therefore would be a likely source of additional funds to address a Money Pool loss or actually support a LUCo guarantee. As previously stated, the Applicants represent approximately 50% of LUCo's business. LUCo represents approximately 80% of Algonquin's business. Thus, the Applicants appear to have a significant exposure to any Money Pool loss.

Conclusion

For the reasons stated in this filing, Staff recommends that the Commission deny the Applicants' request for waivers from Commission Rules in this Application.

⁷ The Money Pool agreements reviewed by Staff that reflected these treatments were the Avangrid Virtual Money Pool Agreement, Black Hills Utility Money Pool Agreement and the National Grid USA Regulated Money Pool Agreement.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

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

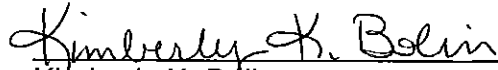
Case No. AO-2018-0179

AFFIDAVIT OF KIMBERLY K. BOLIN

State of Missouri)
) ss
County of Cole)

COMES NOW Kimberly K. Bolin, and on her oath declares that she is of sound mind and lawful age; that she contributed to the attached *Staff Recommendation*; and that the same is true and correct according to her best knowledge and belief.


Further the Affiant sayeth not.



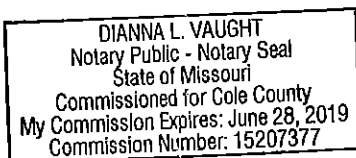
Kimberly K. Bolin

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 31st day of May, 2018.



NOTARY PUBLIC



**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of The Empire District)
Electric Company, The Empire District Gas Company,))
Liberty Utilities (Midstates Natural Gas) Corp., and)
Liberty Utilities (Missouri Water) LLC for an Affiliate)
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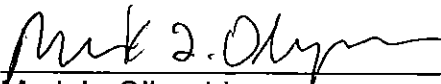
Case No. AO-2018-0179

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

State of Missouri)
) ss
County of Cole)

COMES NOW Mark L. Oligschlaeger, and on his oath declares that he is of sound mind and lawful age; that he contributed to the attached *Staff Recommendation*; and that the same is true and correct according to his best knowledge and belief.

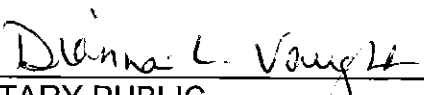
Further the Affiant sayeth not.



Mark L. Oligschlaeger

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 31st day of May, 2018.



NOTARY PUBLIC

DIANNA L. VAUGHT Notary Public - Notary Seal State of Missouri Commissioned for Cole County My Commission Expires: June 28, 2019 Commission Number: 15207377
