ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE ADOPTION)
OF AFFILIATE TRANSACTION RULES)

DOCKET NO. 06-112-R
ORDER NO. 7

ORDER

By Order No. 4 of this docket, entered on December 19, 2006, this Commission adopted *Affiliate Transaction Rules* ("Affiliate Rules"), finding that the Commission has the jurisdiction, and it is in the public interest, to do so. By Order No. 5 of this docket, entered on January 10, 2007, the Commission made a minor correction to Rule IX regarding the dates for filing of Annual Certifications of Compliance. On February 16, 2007, Order No. 6 of this docket was entered in response to numerous petitions for rehearing, requests for stay and motions for clarification (the "petitions"). By Order No. 6 the Commission determined that the petitions had raised certain issues regarding Order No. 4 and the Affiliate Rules that merited further consideration by the Commission. Therefore, the petitions were granted, the Affiliate Rules were stayed on a temporary basis, and a procedural schedule was established for the purpose of allowing the petitioners to propose specific amendments to the Affiliate Rules and allowing other parties to file comments regarding those amendments. A hearing on the petitions was scheduled for March 27, 2007. The scope of the hearing was limited to the proposed specific amendments to the Affiliate Rules and comments filed in response thereto.

On March 13, 2007, a *Joint Utility Proposed Modifications to Affiliate Rules* ("Joint Modifications") was filed by CenterPoint Energy Resources Corporation, Inc., Entergy Arkansas, Inc., Arkansas Western Gas Company, Southwestern Electric Power Company, Arkansas Oklahoma Gas Corporation, Oklahoma Gas and Electric Company, United Water

Arkansas, Inc. and the Empire District Electric Company (collectively "the Utilities"). On March 20, 2007, responses to the Joint Modifications were filed by the Consumer Utilities Rate Advocacy Division of the Attorney General's Office ("the AG"), the General Staff of the Arkansas Public Service Commission ("Staff"), and Arkansas Electric Energy Consumers, Inc. and Arkansas Gas Consumers, Inc. (collectively "Consumers").

Through the explanation provided by the Utilities in the Joint Modifications and the Utilities' statements at the March 27th public hearing, the Utilities explained that the purpose of the Joint Modifications was: (1) to make as few changes as possible to the Affiliate Rules adopted by Order No. 4; (2) to retain the purpose of the Affiliate Rules as set forth by the Commission in the adopted rules; (3) to provide the Commission with express authority to override the proposed rules when necessitated in specific instances; and (4) to provide utilities with the needed flexibility to conduct their utility business and non-utility business in an effective and economical manner, but also in a manner that protects ratepayers and the public interest, consistent with the intent of the Affiliate Rules. (T. 13-14).

In response to the Joint Modifications both the Staff and the AG filed responses which recommended certain changes to the Joint Modifications proposed by the Utilities. As a result, the Utilities filed Amended Joint Modifications on March 26, 2007. At the March 27 hearing, the Utilities asserted that through the Amended Joint Modifications they have "adopted and incorporated the proposed changes of the Attorney General and the Staff, with minor revisions, into their Joint Modifications . . ." (T. 16). At the hearing, the AG stated that the AG, in its response to the Joint Modifications, had proposed certain modifications to the Joint Modifications sponsored by the Utilities and the utilities in turn suggested other language as an alternative to the AG's recommended changes, and those modifications then were included by

the Utilities in their Amended Joint Modifications. The AG stated that the alternative language addresses the AG's concerns. The AG also stated that the AG has reviewed the Amended Joint Modifications addressing the Staff's recommended changes and finds nothing in those changes objectionable. Therefore, the AG states that the AG has no objections to the amended modifications. (T. 17-18).

Likewise, at the hearing, Staff stated that Staff believes the Amended Joint Modifications provide an equally effective framework for oversight of affiliate transactions as that provided in the adopted Affiliate Rules and would enable a more efficient use of resources of the Commission, Staff and the Utilities and other interested parties. (T. 25). Staff goes on to state that the Amended Joint Modifications incorporate substantially all the changes recommended by Staff and the AG and represent a reasonable regulatory framework for affiliate transactions rules. (T. 25-26).

The only party currently opposing the Amended Joint Modifications is Consumers. Consumers argue that the amended Joint Modifications "drastically alter the purpose of the Rules." (T. 12) Consumers' assertion is disputed by the Utilities, the AG and Staff, who agree that the amended Joint Modifications are consistent with the purpose of the earlier adopted Affiliate Rules. The Commission will address each of Consumers' objections to the changes proposed in the Joint Modifications.

Consumers assert that Rule III.G contains exemptions which appear to be "designed to allow a utility to purchase electricity, natural gas, and other services from an affiliate without complying with the Rules' reporting and pricing requirements." (T. 121) This Commission disagrees with this assertion given that the changes to Rule III.G remove certain transactions from prior approval requirements under the rules, but would continue to require reporting of

those transactions. Additionally, Rule III.G is directed primarily at purchases which are subject to a purchased gas adjustment, purchased power adjustment, fuel adjustment or similar mechanism, or are subject to the electric cooperative exemption under Ark. Code Ann. §23-3-102(e)(2). The purchased gas, power and fuel adjustments are dealt with outside rate case proceedings and are customarily done on an annual basis and subjected to appropriate prudence review. Further, the cost of fuel will be considered within the context of the Commission's Integrated Resource Planning Guidelines as applied to each electric utility. Also, the cost of gas for gas utilities will be considered within the annual gas supply plans submitted in compliance with the Commission's *Natural Gas Procurement Plan Rules*. Thus, there seems to be little merit to Consumers' objections (see T. 121) that Consumers would be required to wait for a rate case filing to review these adjustments or that the adjustments could be made without complying with the reporting requirements of the rules.

Consumers object to Rule IV.C.3 of the Joint Modifications asserting that the Utilities propose to exempt transactions concerning the factoring of accounts receivable, special purpose financing entities and the use of money pool arrangements subject to "safeguards." Consumers assert that the modifications fail to give Consumers confidence that there will be reasonable oversight and this Commission should therefore reject these amendments. Other than the statement that the modifications to Rule IV.C.3 do not give Consumers confidence that there will be reasonable oversight, Consumers do not attempt to explain why the proposed modifications are unreasonable. Consumers do ask; "What safeguards are to be implemented?" "Who decides whether a particular safeguard is adequate?" and "Will the Commission and the Consumers have an opportunity to review proposed safeguards prior to implementation?" (T. 122).

The Utilities explained that the exceptions added to Rule IV, including those contained in Rule IV.C.3 concerning cash management programs, are modeled after Federal Energy Regulatory Commission ("FERC") rules. (T. 43). Additionally, the Utilities noted that a new Rule IV.D was added to clarify that nothing in Rule IV would alter or amend the Commission's obligations or allow encumbrances which would otherwise be in violation of Rule 5.01 of the Commission's Rules of Practice and Procedure. (T. 44). Several of the Utilities explained, in their initial comments, the need to allow these cash management programs.

This Commission believes that the Utilities have justified the need for the cash management programs and that the exemptions offered to Rule IV.C.3 are reasonable. Further, the Commission agrees with the reasoning of the FERC allowing such cash management programs, subject to safeguards. The FERC has stated:

> In Order No. 669, the Commission stated that cash management programs, money pools and other intra-holding company finance arrangements[2] are a routine and important tool used by many large companies to lower the cost of capital for their regulated subsidiaries and to improve the rate of return the holding company and its subsidiaries can receive on their money.[3] These transactions often involved issuances and acquisitions of securities that are subjected to FPA sections 204 and 203.[4] The Commission stated that it did not intend to make it more difficult for companies to take advantage of these types of transactions. Transfers of funds between such companies do not generally present competitive problems. Thus, we found that it was consistent with the public interest to grant blanket authorization under section 203(a)(2) for holding companies and their subsidiaries to take part in intra-system cash management-type programs.

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[2] While there are several different types of cash management programs, a cash management program generally involves pooling the cash resources of several affiliated companies into a "money pool." Affiliates can than borrow against the funds in the pool, often at below market rates. Additionally, the parent company is often able to achieve a higher rate of return on its money pool investments than any single affiliate could on its on. For a detail discussion of cash management programs, see Regulation of Cash Management Practices, Order No. 634, 68FR40500, July 18, 2003, III FERC Stats. Regs. ¶ 31,145 (June 26, 2003) Order No. 634-A, 68 FR 61993 (Oct. 31, 2003), FERC Stats. & Regs. ¶ 31,152 (Oct. 23, 2003) (Cash Management Rule).

[3] Order No. 669 at P 142.

[4] The Commission's authority under section 204 governing the issuance of securities by a public utility was often superseded by the authority of the SEC under section 318 of the FPA. Section 318 of the FPA resolved conflicts of jurisdiction between the FPA and PUHCA 1935 regarding, among other things, the issuance of securities in favor of the SEC. Section 318 was repealed under section 1277 of PUHCA 2005.

(FERC Docket No. RM05-34-001; Order No. 669-A, paragraph 84, issued April 24, 2006).

In response to objections in FERC Docket No. RM05-34-001 which were very similar to the objections asserted by Consumers, the FERC stated:

> APPA/NRECA assert that the Commission granted blanket authorization for intra-holding company financing transactions without adequate safeguards against cross-subsidization or pledges or encumbrances of utility assets. In discussing the blanket approval of these arrangements, Order No. 669 states that applicants "must adopt sufficient safeguards, including any necessary cash management controls (such as restrictions on upstream transfers of funds, ring fencing, etc.) to prevent any cross-subsidization between holding companies and their new subsidiaries before receiving section 203 approval."[5] However, APPA/NRECA point out that these requirements do not appear in the Commission's accompanying regulations.

(FERC Docket No. RM05-34-001; Order No. 669-A, paragraph 88, issued April 24, 2006, (emphasis added)).

In again reemphasizing the need for such cash management programs, the FERC stated that such programs are "used by many large companies to lower the cost of capital for their regulated subsidiaries and to improve the rate of return the holding companies and subsidiaries can receive." (FERC Docket No. RM05-34-002; Order No. 669-B, paragraph 18, July 20, 2006).

To provide clarification the FERC amended Part 33 of Chapter I, Title 18, *Code of Regulations*, § 33.2 (j)(1) to require utilities to provide an explanation "[o]f how applicants are providing assurance, based on facts and circumstances known to them or that are reasonably foreseeable, that the proposed transaction will not result in, at the time of the transaction or in the future, cross-subsidization of a non-utility associate company or pledge or encumbrance of utility assets for the benefit of an associate company . . " (See FERC Docket No. RM05-34-002; Order No. 669-B, Attachment A, July 20, 2006).

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[5] APPA/NRECA Rehearing request at 30 (citing Order No. 669at P 143).

Clearly the safeguards referred to by the FERC are those contained in the FERC's Rules. Likewise, the safeguards referred to in proposed Rule IV.C.3 are those safeguards provided in the recordkeeping and filing requirements in Rule VI of the proposed rules as well as Rule IX regarding compliance, and other rules, such as Rule 5.03 of the Commission's Rules of Practice and Procedure. Additionally, internal corporate arrangements, including money pool arrangements, are subject to appropriate prudence review in a rate case or other regulatory proceeding. Although the proposed Affiliate Transaction Rules do not require prior approval for these transactions, the transactions are required to be disclosed under the reporting requirements of Rule VI A.4.d and they are subject to review by the Commission which would include an appropriate prudence review or a finding by the Commission under Rule IV.C that the arrangement is not consistent with the purpose of the Affiliate Transaction Rules. Because Consumers have offered no reason to determine that these numerous safe guards are inadequate, the Commission finds no merit to Consumers' objections to Rule IV.C.3.

Consumers argue that Rule IV.C. 4-5 conflicts with Ark. Code Ann. §23-3-103. (T. 123). Section 23-3-103 concerns the power of public utilities to issue stocks, stock certificates, bonds, notes, etc., and states, "This power shall be exercised as provided by law and under such rules and regulations as the Commission may prescribe." Rule IV.C would not provide exemptions which are inconsistent with applicable law such as §23-3-103 because the rule itself prohibits such an interpretation. Rule IV.C requires that the exemption therein allowed must be "consistent with applicable law." The rule would not allow exemptions for stock issues or the placement of encumbrances on utility property which are governed by statutes or other Commission rules such as those contained at Ark. Code Ann. §23-3-301 *et seq*. Further, Rule IV.D provides that nothing in Rule IV "shall alter or amend the Commission's authority or the

obligation of public utilities set out in Rule 5.01 of the Commission's Rules of Practice and Procedure." Rule 5.01 implements Ark. Code Ann. §23-3-301 *et seq*. and governs the issuance of stock, bonds and other evidence of indebtedness and contains provisions limiting encumbrances on public utility property. The Commission cannot find any conflict between Rule IV.C. 4-5 and Ark. Code Ann. §23-3-103.

Consumers object to Rule IV.C.8 claiming that they "have no clue on the number of financial transaction these utilities currently have with their affiliates." (T. 123-124). This rule was modified in a manner that appears to meet Consumers' concerns in the filing of Mach 26, 2007. The Utilities modified Rule IV.C.8, apparently at the behest of Staff, to provide that the utilities must file with the Commission a description of affiliate arrangements existing as of the effective date of these rules within 120 days of the effective date. This will allow Consumers to review existing transactions and this filing should provide Consumers with the "knowledge they need to determine in the future whether a utility has complied with the new Rules." (T. 124).

Consumers object to the exceptions added by the utilities to Rule V. Particularly, Consumers object to the provisions contained in Rule V.B.2-3. (T. 1.4). Rule V. B.2-3 allows "the provision of shared corporate support services, at fully allocated costs, between or among a public utility and any affiliate, including a service company" and "the provision, at fully allocated costs of assets, goods, services, or personnel or between a public utility and rate-regulated utility in another state of the United States." This provision is being modified by the Commission to allow sharing at fully allocated costs, of assets, goods, services, or personnel between or among a public utility and an affiliated rate regulated utility in another state.

Consumers assert that the exceptions added by the Utilities would lessen the pricing restrictions established in Rule V.A. (T. 125). In arguing against the exemptions, Consumers states:

> The indiscriminate use of shared services could be detrimental to a jurisdictional utility, because the holding company, which hires and fires the shared employees, has a different priority and obligation than the affiliate. This is inherent. It is especially true when the utility's priorities are at odds with those of its affiliate. The regulated affiliate has an obligation to provide the lowest cost utility service to its captive customers. Presumably, it has an overwhelming interest in the maximization of profits to shareholders. It does not have any incentive to protect one of its affiliates' ratepayers over another, because it will be made whole regardless of the outcome of a particular case. A jurisdictional utility's first priority should be to its ratepayers.

(T. 125). In explaining the added exemptions, the Utilities state, "The new exemptions from the asymmetrical rule in Rules V.B.2, B.3, and B.4 allow a public utility to provide or receive service from a rate regulated utility in another state at fully allocated cost and allow shared corporate services to be provided by any entity (a utility, a service company or other affiliate) at fully allocated cost. Services provided under competitive bidding or pursuant to regulatory filed or approved tariff or contract are exempt." (T.45). This explanation by the Utilities merely describes what the exemptions do and does not offer justification for those exemptions. Likewise, Consumers objections to the new exemptions are general statements which support the need for affiliate transaction rules but do not specifically address the new exemptions in Rule V.

Rule V, as originally proposed by the Commission, deals with affiliate transactions other than financial transactions and would prohibit a utility from receiving anything of value (i.e. assets, goods, services, information having competitive value or personnel) unless the compensation paid by the utility does not exceed the lower of market price or fully allocated costs. The rule also prohibited the utility from providing anything of value unless the

compensation received by the public utility is no less than the higher of market price or fully allocated costs of the item provided. The exceptions contained in proposed Rule V.B.2 and 3 are generally consistent with the Commission's original Rule V.A. Under the new exemptions, a utility can provide shared corporate support services at fully allocated costs or provide assets, goods, services or personnel at fully allocated costs. The only significant difference created by Rule V.B.2 and 3 is that the exemptions provided allow the provision of services in certain circumstances at fully allocated cost but do not require that such services be provided at the lesser of market price or fully allocated costs. The fully allocated cost requirement would guarantee full recovery of all costs incurred by the utility in the provision of such services, goods or personnel and it would prohibit the utility from profiting from the provision of such goods, services or personnel by charging a market price if that market price is greater than fully allocated costs. However, if such assets, goods, services, or personnel can reasonably be acquired elsewhere by the public utility on more favorable terms and conditions than fully allocated costs, then the public utility should do so.

As noted by the Utilities' witness, Mr. Harmon, ". . . when we came up with this language, our concern was the definition of affiliate reads, two operating divisions of the same corporation would be technically affiliates, and there would, of course, be needs for them to share information amongst one another, and so that was the intent, but it was a sister division within the same holding company or same utility system." (T. 101). Mr. Harmon's explanation was given in response to a question regarding the provision of services to a rate regulated utility in another state and was designed to support the Commission's assumption that the rate regulated utility in another state would be an affiliate of the utility providing the service; however, Mr. Harmon's observation that the definition of an affiliate would include operating divisions of the

same corporation justify the exemptions made in Rule V.B.2 and 3. Operating divisions of a public utility would work more efficiently if they are allowed to share goods, services, and personnel subject to the protections contained in the affiliate rules but without the requirement to charge the higher of fully allocated cost or market price and receive at the lesser of the two.

The purpose of affiliate rules is not to stifle the utility's ability to conduct business efficiently but rather to guard against affiliate transactions which work to the detriment of ratepayers. A blanket prohibition on the exchange of goods, services or personnel between the divisions of a utility would not promote efficiency and could result from application of the asymmetrical pricing rule. The exemptions offered by the Utilities are therefore reasonable.

Additionally, the Commission can envision circumstances where the sharing of personnel would clearly be in the public interest, such as when a natural disaster occurs. A utility's ability to provide personnel and goods to aid an affiliate-regulated utility in another state is clearly in the public interest, and this provides further justification for the exceptions requested by the Utilities.

With regard to Rule V.B.4, this exemption allows utilities to provide goods, services or information pursuant to competitive bidding or a regulatory approved tariff or contract. When a utility service is requested, the utility is required to provide the service at a tariff rate or approved contract rate. In instances where an approved tariff or contract exists and covers the rates to be charged for the provision of assets, goods, services or information, the utility is bound by law to provide such services at the approved tariff or contract rate and the exemption merely recognizes that fact. If a utility chooses to provide assets, goods, services or information for which there is no established market price and no approved tariff or contract, competitive bidding would be appropriate and the exemption recognizes that fact. Given the need for the utilities to conduct

business in an efficient manner, and because the Commission never anticipated that all transactions entered into by a utility with an affiliate would be subject to prior Commission scrutiny, the Commission finds no merit to Consumers' objection to the utilities proposed exceptions contained in Rule V.B.

Consumers object to the changes proposed by the Utilities to Rule VI.A.3 which deals with the creation of a new affiliate. Consumers object on two grounds. First, Consumers are concerned with the change in the timeframe in which the Utilities are required to provide notice of creation of a new affiliate and, second, Consumers have several questions regarding how the notice of the creation of a new affiliate is to be made if not through an electronic bulletin board.

With regard to the first issue, the original rule provided that a utility was to immediately notify the Commission of the creation of a new affiliate and post such notice on an electronic bulletin board and, within 60 days after the creation of the affiliate, file with the Commission an explanation of how the public utility will implement these rules with respect to such new affiliate. The proposed changes would allow the utility to both notify the Commission, and explain how the public utility would implement these rules with respect to such new affiliate, within 60 days of the creation of the affiliate. At this point, it should be noted that the new affiliate would not be permitted to enter into transactions which require prior approval under the proposed rules during that 60-day period. Thus, the protections afforded by the rules would be applicable to the new affiliate at all times. Given the protections afforded by these rules, as well as other rules and statutes governing affiliate transactions, the 60-day notice requirement seems reasonable, particularly in view of the fact that the utility would be required to provide an explanation of how the public utility would implement these rules with respect to the new affiliate at the time the notice is provided. Further, this is essentially consistent with the

Commission's original proposal that the utility provide the explanation within 60 days of the creation of the affiliate.

With regard to how the notice and explanation is to be administratively dealt with by the Commission, Consumers raise some legitimate questions. Because the questions center primarily on how the Secretary of the Commission is expected to deal with the notices, the Commission sees no need to change the proposed rules, rather, through this Order the Commission will establish administrative procedures for the Secretary of the Commission and the utilities to follow in filing the notices.

First, the Commission notes that when a utility files notice of a new affiliate, that filing will appear on the Commission's website in the daily filings and the Commission is of the opinion that this serves as an adequate electronic bulletin board. To determine if a utility has filed a notice of creation of a new affiliate or has filed any other report required under these rules, one would only need to check the daily filings on the Commission's website.

The Secretary of the Commission is directed to establish a separate docket for each utility required to make filings under these rules. The docket shall be styled "In the Matter of Affiliate Transaction Rules Filings by (name of utility)." Once such a docket is established, the docket will remain open for all other filings required by the utility under these rules. This will enable a party seeking to research the filings of a specific utility to review the filings in a docket which relates specifically to the utility in question and will dispense with the need to cull specific utility filings from a massive integrated docket. The Commission believes this is an efficient manner in which to deal with the filings and to make them as readily accessible to the public as possible.

Consumers object to the proposed changes the Utilities have made to Rule VII concerning bond rating downgrades. Specifically, Consumers object to; the change in Rule VII

which limits application of the rule to utilities that have separate stand alone bond ratings, the change in Section B of the rule which requires the utilities to provide a copy of publicly released information as opposed to a "full explanation", and the provision in proposed Section D (now Section C) that will require the utility to terminate its relationship if the Commission finds that the bond rating downgrade would not have occurred but for one or more relationships between a public utility and one or more affiliates.

Consumers also object to proposed Section C, which would have required the utility to retain a financial expert to advise the Commission with regard to the downgrade; however, after the utilities proposed to modify that revision to require Staff to retain the expert, the provision has been omitted from the rule. The Commission Staff has the ability, with the Commission's approval, to retain experts and the issues regarding original proposed Section C have become moot.

With regard to the exception placed in the rule which limits application of the rule to separate utilities having a standalone bond rating, Consumers state that, "Consumers believe that the bond rating downgrade provision should apply to any utility, including a member of a utility holding company system whose bond rating is downgraded as a result of the activities of one of its affiliates. To do otherwise would be to ensure that ratepayers do not receive the protection that they deserve." (T. 127). Consumers offer no explanation whatsoever to support their belief that the bond rating downgrade provision should apply to any utility, nor do they support their conclusion that to do otherwise would ensure that ratepayers do not receive the protection they deserve. Consumers' belief and conclusion appear to suggest that Consumers are of the opinion that the Commission can somehow regulate or take action against non-regulated, nonpublic utilities which have an ownership interest in an Arkansas utility when the affiliate's bond rating

is downgraded. The Commission wholly fails to understand the logic supporting Consumers' conclusion. In any event, Consumers have completely failed to support their belief and conclusion and the Commission therefore finds that Consumers' objections to the modification to Rule VII.A are without merit.

Consumers' objection to the proposed change to the Rule VII.B, which permits a utility to provide a copy of publicly released information as opposed to a full explanation, is equally unsupported. The rule, as modified, requires the utility to provide publicly released information supporting the downgrade. The Commission understands that additional information may be obtained from the utility, and the utility could be required to provide a full explanation; however, such explanation could involve proprietary data which the utility would not want to be on the public record. With this in mind, the Commission understands the proposed change to Rule VII.B and, with the understanding that a full explanation could be required in a proceeding investigating the bond rating downgrade, the Commission finds no merit to Consumers' objection.

Consumers also object to the provision in Rule VII.D (now Rule VII.C) which allows the Commission to impose remedies designed to insulate a public utility and its customers from a bond rating downgrade rather than requiring the utility to terminate the relationship with the affiliate which allegedly caused the downgrade. The Commission believes this change is reasonable and in fact gives the Commission wider discretion since the Commission could require a termination of the affiliate relationship as a remedy, but would not be required to do so. (See also discussion regarding changes to Rule X, infra).

Consumers object to proposed Rule VIII.B asserting that, "The utilities should provide both the APSC and ratepayers a current list of non-utility business they operate now." (T. 127).

This rule has been modified to address Consumers concerns by requiring public utilities to file with the Commission a description of such non-utility businesses existing as of the "effective date of these rules" with such filing to be received within 120 days of the effective date of the rules. (See Rule VIII.B).

Consumers object to the Utilities' modification to Rule X which has been changed to state that the cost of any affiliate transaction found to be inconsistent with the rules shall be deemed void for ratemaking purposes, to state that the cost of affiliate transactions found to be inconsistent with the rules will be adjusted in a ratemaking proceeding. There seems to be little difference in the term "void for ratemaking purposes" and "adjusted in a ratemaking proceeding;" however, Consumers assert that the word change from "void" to "adjusted" alters the meaning of the rule. The only justification provided by Consumers to support its conclusion that that the change alters the meaning of the rule, is Consumers' statement that, "When interpreting the language of a rule, one must construe it just as it reads, giving the words their ordinary and usually accepted meaning in a common language. (T. 128). Apparently, Consumers is of the opinion that the term "void for ratemaking purposes" would effectively void a transaction as opposed to making adjustments to offset the effects of the transactions in a ratemaking proceeding. If this understanding of Consumers' argument is correct, the argument is essentially the same as Consumers argument regarding Rule VII.D which was changed from requiring termination of affiliate relationships to instead allow the Commission to design remedies which would insulate the public utility and its ratepayers from imprudent actions by an affiliate. As noted in the discussion of Rule VII.D, the Commission believes that this could include termination of the relationship; however, as noted by the Utilities, the proposed change to Rule VII.D "gives the Commission wide authority to impose appropriate remedies and avoids

a provision, which many public utilities believe is beyond the jurisdiction of the Commission, purporting to authorize corporate divestitures or restructuring to 'terminations' of affiliate relationships." (T. 48).

In their initial comments several of the Utilities argued that the Commission could not restrict a utility from engaging in a non-utility business citing *Associated Mechanical Contractors of Arkansas v. Arkansas Louisiana Gas Company,* 225 Ark. 424, 283 S.W.2d 123 (1985). (Consumers also cite a case regarding this Commission's jurisdiction "to determine whether it should declare void *ab initio* certain contracts entered into by Arkansas Power & Light Company with respect to the purchase of power from a nuclear power plant located in Mississippi. *Middle South Energy Inc. v. APSC*, 772 F.2d 404, 406 (1985)). Under the proposed rules, the Commission may impose remedies designed to insulate a public utility and its customers from imprudent actions by an affiliate. The Commission is of the opinion that this includes requiring the utility to withdraw from certain contracts if they are contrary to the public interest; however, that is not the issue pending in this docket. The term "void for ratemaking purposes" verses "adjusted in a ratemaking proceeding" is, from this Commission's perspective, essentially the same. Therefore, the Commission finds no merit to Consumers' objection to proposed Rule X.

Recognizing that the Affiliate Rules "clarify the review standards for affiliate transactions in future proceedings and allow for public interest exemptions from the rules" and stressing "the importance of abiding by the rules," Consumers state that they "do not wish to witness another situation such as the Arkansas Power & Light situation in the 1980s, where the United States Court of Appeals in the Eighth Circuit enjoined the Arkansas Public Service Commission from continuing proceedings to determine whether it should declare certain

contracts entered into by AP&L void." (T. 21). The case referred to by Consumers is *Middle South Energy, Inc. v. Arkansas Public Service Commission*, 772 F.2d 404 (1985). In that case, the Eighth Circuit Court of Appeals affirmed a decision of the District Court granting an injunction against this Commission. In explaining its decision, the Eighth Circuit stated:

> The district court's decision on preemption grounds was based on the Federal Power Act. Congress' purpose in enacting the Act was to regulate "the transmission of electric energy in interstate commerce and ... the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b) (1982). To accomplish this goal, Congress gave FERC the power to make "just and reasonable" any public utility "rule, regulation, practice or contract affecting [a] rate, charge, or classification [that] is unjust, unreasonable, unduly discriminatory or preferential." Id. § 824(e)(a).

Middle South v. APSC, 772 F.2d 404, 441 (1985).

Consumers argument referencing the Middle South case seems inconsistent with Consumers' assertion that the "Commission's primary goal must be to attempt to fill the post-PUCHA regulatory gap." (T. 19). The regulatory gap referred to by Consumers resulted from the *Energy Policy Act of 2005*, which repealed the *Public Utility Holding Company Act of 1935*. The Middle South case, decided in 1985, seems to have little bearing on the issues being addressed in this docket, i.e. the regulatory gap created by the adoption of the *Energy Policy Act of 2005,* because there was no regulatory gap at the time the Middle South case was decided. The Commission fails to understand how the district court's decision on preemption grounds based on the Federal Power Act would be affected by the adoption of affiliate transaction limitations advocated by Consumers in this docket.

The Commission acknowledges that the Affiliate Rules may require amendment as the parties and the Commission gain experience with specific application of the rules. Consumers, Staff and the AG are at liberty, and are encouraged, to bring to the Commission's attention any

occurrences which may require Commission review of a specific transaction or modification of the Commission's Affiliate Rules.

At the hearing, certain questions were posed by the Commission seeking clarification. Regarding Rule V.B.1.c the Commission asked if the term "any rate-regulated utility in another state of the United States" refers to a sister division operating in another state. (T. 100-101). The Commission was assured that the assumption is correct and it was suggested that inserting the word "affiliated" prior to the previously quoted phrase would clarify the rule. In order to clarify this provision the Commission has made the appropriate change to Rules V.B.1.c and V.B.3.

Rule IV, in part, prohibits a utility from providing to or sharing with an affiliate any financial resource except as otherwise provided in the rule or in other applicable law. Rule IV.C exempts certain transactions from the prohibition of Rule IV unless the Commission finds, after notice and hearing, that such transaction(s) is not consistent with the purposes of the rules as defined in Rule II. One of the transactions so exempted from Rule IV.C (at IV.C.8) is "[a]ny financing arrangement involving a public utility and any affiliate that was in existence as of the effective date of these rules; provided the public utility files with the Commission a description of each such arrangement involving a public utility and any affiliate having an annual value or amount in excess of $350,000 and such filing is received within 120 days of the effective date of these rules." During the hearing the Chairman asked the Joint Utility witness panel how they came up with the $350,000 threshold amount. CenterPoint witness Bill Harmon answered that "[t]he utilities had ... suggested that requiring a report of every single tiny two dollar transaction would be burdensome to create and burdensome for the Commission to review, and some

numbers were thrown about as to what might be an appropriate threshold below which it was so immaterial that it wouldn't matter, and the number $350,000 was arrived at." (T. 102-103)

The Commission is somewhat concerned that the $350,000 threshold could be circumvented by a utility choosing to enter into a series of closely related financial transactions with an affiliate in which each transaction is below the $350,000 threshold but the total of the series of transactions is greater that the $350,000 threshold. To do so would violate the intent of the $350,000 threshold. Accordingly, all utilities will be held not only to the express terms of the Rule IV.C.8 exception but also will be held to the intent of the $350,000 threshold exception as well.

Order No. 4 of this docket explained the basis for the Commission's authority to adopt Affiliate Rules. Order No. 4 also discussed the appropriate standard for review in a Commission rulemaking proceeding. The Commission finds that nothing in the comments submitted since the issuance of Order No. 4 requires any changes to the findings made in Order No. 4 other than those changes incorporated in Order No. 5 and in this order.

This Commission finds that the Affiliate Rules attached to this Order are within the Commission's jurisdiction to adopt for the reasons stated in Order No. 4 of this docket. Further, the Commission finds that the attached Affiliate Rules are reasonable, they are fully consistent with Commission's stated purpose for adopting affiliate rules, and that it is in the public interest to adopt the attached rules.

Therefore, the *Affiliate Transaction Rules* (Attachment A hereto) are hereby adopted and shall be applicable to all jurisdictional rate-regulated public utilities with the exception of the

Distribution Coops and AECC.[6] Attachment B hereto reflects the changes made to Rule V from the Joint Utility Proposed Modifications filed in this docket on March 26, 2007.

Staff is directed to fulfill the requirements of Ark. Code Ann. §25-15-204(d)(1) and Ark. Code Ann. §10-3-309 on behalf of the Commission, and to make its compliance filings in this docket.

BY ORDER OF THE COMMISSION.

This 25th day of May, 2007.

Paul Suskie, Chairman

Sandra L. Hochstetter, Commissioner

Daryl E. Bassett, Commissioner

Diana K. Wilson
Secretary of the Commission

I hereby certify that the following order issued by the Arkansas Public Service Commission has been served on all parties of record this date by U.S. mail with postage prepaid, using the address of each party as indicated in the official docket file.

Diana K. Wilson
Secretary of the Commission
Date 5/25/07

[6] The March 21, 2007, *Petition for Exemption and Exclusion from Affiliate Transaction Rules* filed on behalf of United Water Arkansas, Inc. remains under advisement.