

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter, on the Commission's own motion,)	
to consider changes to its guidelines for)	Case No. U-11916
transactions between affiliates.)	
_____)	

At the May 3, 2000 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. John G. Strand, Chairman
Hon. David A. Svanda, Commissioner
Hon. Robert B. Nelson, Commissioner

OPINION AND ORDER

History of Proceedings

On March 8, 1999, the Commission issued an order and notice of hearing to consider changes to previously issued guidelines relating to transactions between affiliates of a public utility. In that order, at 1-2, the Commission described the objectives of the proceeding as follows:

Several years have passed since the Commission imposed these guidelines on [Consumers Energy Company, SEMCO Energy Gas Company, and Michigan Consolidated Gas Company¹]. During that time, significant changes have occurred in Michigan's electric and gas industries, including the advent of retail competition. The Commission

¹In its December 7, 1989 order in Cases Nos. U-8678, U-8924, and U-9197, its May 7, 1991 order in Case No. U-9346, its June 19, 1990 order in Case No. U-9323, and its October 28, 1993 order in Cases Nos. U-10149 and U-10150, in which the Commission approved base rates for Consumers Energy Company's Gas and Electric Divisions, SEMCO Energy Gas Company (as the successor in interest to Michigan Gas Company), and Michigan Consolidated Gas Company, respectively, the Commission also established the guidelines applicable to each utility's affiliate transactions.

therefore finds that it should initiate a contested case proceeding to (1) review these requirements, (2) determine which of the guidelines may no longer be appropriate or what new conditions may be required in today's industry, and (3) decide whether to expand or reduce the list of entities to which these requirements should apply.

At a prehearing conference on April 7, 1999, Administrative Law Judge James N. Rigas (ALJ) granted leave to intervene to Energy Michigan, Attorney General Jennifer M. Granholm, the Michigan Electric Cooperative Association (MECA), the Michigan Independent Power Producers Association (MIPPA), SEMCO Energy Gas Company (SEMCO), Wisconsin Public Service Corporation and Upper Peninsula Power Company (WPS Corp/UPPCo), the National Energy Marketers Association (NEMA), the Michigan Alliance for Fair Competition (MAFC), Indiana Michigan Power Company, the Michigan Cable Telecommunications Association (the MCTA), Shell Western E&P Inc., the Michigan State Utility Workers Council, Utility Workers Union of America, AFL-CIO (the MSUWC), the Michigan Petroleum Association/Michigan Association of Convenience Stores (the MPA/MACS), Consumers Energy Company (Consumers), The Detroit Edison Company (Detroit Edison), the Association of Businesses Advocating Tariff Equity (ABATE), Edison Sault Electric Company, PG&E Corporation, Fiber Link, Inc., CMS Enterprises Company, and Michigan Consolidated Gas Company (Mich Con). The Commission Staff (Staff) also participated. On May 19, 1999, the ALJ granted Detroit Edison leave to withdraw from the case. Tr. 70-71.

On July 28 and 29, 1999, the ALJ conducted evidentiary hearings. Thereafter, WPS Corp/UPPCo, SEMCO, ABATE, the MSUWC, MAFC, Consumers, MECA, the Staff, Mich Con, NEMA, the MCTA, the MPA/MACS, and MIPPA filed briefs. Except for ABATE, the MSUWC, and MAFC, the same parties also filed reply briefs.

On October 27, 1999, the ALJ issued a Proposal for Decision (PFD). For the most part, the ALJ recommended that the guidelines be reaffirmed, subject only to minor revisions proposed by the Staff. With respect to Guidelines 6 and 7, the ALJ recommended deletion of text that suggests a prescriptive methodology for pricing transfers of assets between a utility and its affiliates. In the ALJ's view, the function of the guidelines is to set reporting and recordkeeping standards, not to dictate whether or how a utility conducts transactions with affiliates.

The ALJ also recommended adoption of two new guidelines. Guideline 8, as proposed by the Staff, would require a utility to disclose arrangements that secure financing for affiliates by collateralizing or otherwise encumbering the utility's assets. The second new guideline, denominated as Guideline 9, would permit utilities to petition the Commission for waivers from guideline requirements on a case-by-case basis for good cause.

The ALJ recommended that the guidelines be extended to all regulated electric and gas utilities, including rural electric cooperatives. However, the ALJ did not agree that the guidelines should be extended to cover telecommunications providers.

On November 10, 1999, ABATE, MAFC, the MCTA, MIPPA, NEMA, and the MSUWC filed exceptions to the PFD. On November 22, 1999, the Staff, Mich Con, Consumers, and SEMCO and WPS Corp/UPPCo (collectively, SEMCO/WPS Corp/UPPCo) filed replies to exceptions.

Proposed Guideline Changes

a. Guidelines 1 to 3

In their current form, the first three guidelines establish basic obligations to maintain and provide access to records. Guideline 1 states that a public utility must ensure that the Commission has access to the books and records of the utility's holding company and each of the affiliates and

their joint ventures. Guideline 2 requires utilities and affiliates to use procedures and controls that ensure full Commission review of cost allocations and transfer pricing and provide protection against cross-subsidization. Guideline 3 requires books to be kept in accordance with generally accepted accounting principles and, when applicable, the Uniform System of Accounts. The ALJ recommended that these three guidelines should continue in effect. No one filed exceptions. The Commission therefore determines that Guidelines 1 to 3 are appropriate and that they should remain in effect.

The second sentence of existing Guideline 1 includes a phrase that is meant to convey that the entity from which disclosure is sought must either object or provide access to the books and records. Guideline 1 has been reworded to clarify the intended meaning.

b. Guideline 4

Existing Guideline 4 describes the financial statements and other information that public utilities must provide to the Commission and prescribes reporting intervals for each category of information. The Staff proposed several revisions. One Staff recommendation was that the Guideline 4(c) obligation to provide, “[a]s a separate exhibit in its next general rate case, an audit report of its transactions between the utility and its non-utility affiliates,” March 8, 1999 order, Ex. A, be modified so that each utility instead files an audit report at the end of year 2000 and for each three-year interval thereafter. The ALJ accepted the Staff’s proposed revisions.

In its exceptions, NEMA argues that a three-year cycle for audit reports allows for too much time to lapse before a public utility must disclose improper dealings. NEMA says that the Staff rationale—that it has too few employees and resources to review audits on a more frequent basis—is inadequate by itself. NEMA contends that frequent reporting is itself a disincentive against improper affiliate dealings and that parties other than the Staff can review the reports and pursue

appropriate responses to any improprieties that are revealed. Because utilities are already required to maintain records and file reports annually pursuant to MCL 460.556; MSA 22.156, NEMA does not believe that it would be burdensome for them to take the additional step of preparing audit reports. NEMA would prefer audit reports to be filed annually or perhaps biennially.

Consumers responds that preparing annual audit reports would be burdensome, that the Staff lacks the resources to administer more frequent reporting, that utilities are subject to other reporting obligations that respond to NEMA's concerns, and that the payment of interest is adequate to compensate for the time value of any delay in disclosing improper dealings. Mich Con says that NEMA's predictions regarding the inevitability of cross-subsidization are exaggerated. According to Mich Con, its objective is not to conceal improprieties, but instead to secure a level playing field that allows it to benefit from its economies of scope and scale. Consumers and SEMCO/WPS Corp/UPPCo say that there is no record support for NEMA's recommendation.

The Commission agrees that the changes proposed by the Staff for Guideline 4 should be adopted, including the three-year cycle for audit reports. NEMA has not shown that any incremental benefit of reporting on a shorter cycle would justify the effort and cost required to conduct the audits and prepare the reports. In addition, the Commission will revise Guideline 4(d) to indicate that more frequent audits may be appropriate in some circumstances. The Commission's statutory authority to conduct audits is not restricted by a certain time period or reporting cycle. See MCL 460.56; MSA 22.6. The Commission directs the Staff to require or conduct audits related to affiliate dealings more frequently than the three-year cycle if a utility's regular audit reports reveal a pattern of questionable dealings with its affiliates or if there is any other indication of misconduct. In this manner, the Commission will continue to monitor those utilities whose activities indicate an ongoing pattern of affiliate abuse or violations of these guidelines.

The Commission additionally notes that the ALJ's specific recommendation was to adopt the Staff's position "as shown in Consumers' Attachment B, 'Staff Restated by CEC Co.'" PFD at 20. Consumers' recapitulation of the Staff's proposed Guideline 4(b) inserts a \$100,000 fair market value reporting threshold for annual reports describing affiliate transfers. Consumers' initial brief, Attach. B. Because the Staff did not propose a minimum dollar amount for reporting, that threshold has been removed from the guidelines that the Commission approves in this order.

c. Guideline 5

In its current form, Guideline 5 states that a "utility shall avoid a diversion of management talent that would adversely affect the utility" and requires the utility to file an annual report of personnel transfers. The ALJ adopted the Staff's proposal to require the report to identify employees by name and to provide both the department or function within the public utility from which each employee has been transferred and the department or function within the affiliated entity to which the employee has been transferred. No one objected to this recommendation, which the Commission also adopts.

However, the MSUWC had offered testimony proposing additional requirements. The ALJ struck the testimony, finding that it raised matters that should be considered as part of a code of conduct, and not in a proceeding dealing with affiliate guidelines. Tr. 365-67.

In its exceptions, the MSUWC says that Guideline 5 is mandatory, in that it states that a public utility "shall" avoid a diversion of employee resources. The MSUWC contends that, in this respect, Guideline 5 is more substantive than the ALJ's characterization of it as a mere reporting requirement, even though it has been too general to serve as an effective deterrent in actual practice. The MSUWC argues that the ALJ's ruling prevented the record from including proposals to transform Guideline 5 into a meaningful bar against improper diversions of employee resources.

As proposed, the MSUWC's testimony would amend Guideline 5 to preclude employee diversions that affect safety or reliability. In the context of a utility's sale or transfer of an operating unit or generating plant to a third party or unregulated affiliate, the proposal would require the transferee to maintain adequate staffing by offering to retain the utility's employees at their existing wages for 30 months. It would further require the transferor utility to offer a 30-month transition plan to redundant employees and would require the transferee to adopt a 30-month reliability plan to ensure public safety.

In reply, Consumers says that the MSUWC's proposed changes to Guideline 5 are code of conduct issues because they purport to regulate the actions or conduct of a public utility. As such, Consumers maintains, they cannot be addressed as part of affiliate guidelines that deal with accounting and reporting requirements. According to Consumers, the decision in Midland Cogeneration Venture Ltd Partnership v Public Service Comm, 199 Mich App 286; 501 NW2d 573 (1993), precludes the Commission from giving Guideline 5 an expansive effect, stating that it and other guidelines "simply require Consumers to furnish certain financial statements and file various periodic reports regarding its parent corporation and nonregulated affiliates and its transactions." 199 Mich App at 296. Mich Con agrees with Consumers that the MSUWC's proposed changes are well beyond the objectives of the guidelines.

The ALJ correctly determined that the MSUWC's proposed enhancement of Guideline 5 was beyond the scope of this case. The evident objectives of the MSUWC's proposals, to promote safety and reliability and protect the interests of employees and other stakeholders in a business or facility being transferred to an unregulated entity, may have merit in other cases or other forums. However, they are not closely related to the Commission's objective of establishing a uniform, orderly approach to dealing with the regulatory issues created by a public utility's dealings and

relationships with unregulated affiliates conducting non-utility businesses. The Commission finds that the current formulation of Guideline 5, as amended by the Staff's proposals, is adequate to achieve the objectives of the guidelines and that the MSUWC's additional proposals are neither necessary nor appropriate in this case.

d. Guidelines 6 and 7

Current Guidelines 6 and 7 deal with how a public utility and its affiliates price transactions in which they transfer property to each other or exchange goods and services with each other. The first sentence of Guideline 6 requires the utility to provide advance notice to the Commission when it transfers assets or property with a fair market value of more than \$100,000 to a non-utility affiliate. The second sentence of Guideline 6 states that the price for an affiliate transfer of assets shall be equal to the greater of cost or fair market value if the utility is transferring the assets to an unregulated affiliate and the lesser of cost or fair market value if the affiliate is transferring the assets to the utility. The last sentence of Guideline 6 indicates that the price of services and supplies provided by an unregulated enterprise shall be equal to the lesser of market price or 110% of fully allocated cost. Similarly, Guideline 7 applies to the transfer of market data, technology, or similar information from a public utility to a non-utility affiliate and sets the transfer price at cost or fair market value, whichever is more.

With respect to Guideline 6, the ALJ recommended that the Commission adopt the Staff's proposal to require the written notification for an affiliate transfer to include an explanation, with supporting documentation, as to how the transfer price was determined. No one objected to this recommendation, which the Commission adopts.

With respect to both Guidelines 6 and 7, the ALJ stated that, as they are currently phrased, they indicate that the Commission can direct a public utility how to price a transfer. In actuality, the

ALJ stated, transfer pricing is subject to the discretion of the utility and its corporate holding structure. The ALJ recommended deletion of this language, including the last two sentences of Guideline 6 in their entirety.

In its exceptions, the MSUWC disagrees with the ALJ's conclusion that the Commission lacks authority to prescribe transfer pricing. It says that the ALJ's interpretation of the guidelines as nothing more than accounting standards renders them ineffective as a means of preventing cross-subsidization.

In its exceptions, the MCTA urges the Commission to retain asymmetrical pricing, which uses different pricing methodologies, depending upon whether the public utility is buying the property from an affiliate or selling it to an affiliate. (For example, Guideline 6 prices transfers from a utility to an unregulated affiliate at the higher of cost or fair market value, but transfers from an affiliate to a utility at the lower of cost or fair market value.) The MCTA argues that asymmetrical pricing is justified as a means of preventing regulated utilities from abusing their market power by cross-subsidizing unregulated affiliates in competitive markets.

Consumers responds that the guidelines are only a reporting requirement that do not encompass the substantive requirements proposed by the MSUWC and the MCTA. Mich Con says that public utilities attempting to benefit from economies of scope and scale are acting competitively and that a specific pricing methodology is therefore unnecessary. According to Mich Con, the price set by the utility for the transfer would be subject to Commission review for reasonableness. SEMCO/WPS Corp/UPPCo similarly contend that Commission pricing requirements can be enforced in subsequent rate proceedings.

In its reply to exceptions, the Staff says that the Commission should not delete the last two sentences of Guideline 6 altogether, but that it should modify them to clarify their effect. Although

the Staff views the pricing of affiliate transactions as subject to a public utility's managerial discretion, it also asserts that the guidelines' pricing provisions articulate the regulatory standard by which the Commission will adjudicate the ratemaking treatment of asset transfers in future cases. In this regard, the Staff argues that the Commission's authority over rates encompasses the right to approve, disapprove, or modify the company's accounting treatment of affiliate transactions.²

The Commission determines that the pricing provisions set forth in existing Guidelines 6 and 7 should not be deleted. Those provisions are a valid expression of a longstanding regulatory standard. Although the provisions are asymmetrical in the sense that they do not treat transfers of property or resources going from a public utility to its affiliate in the same manner as transfers going the other direction, the asymmetry is justified by the need to make it more difficult for utility companies to account for affiliate dealings in a manner that would be contrary to ratepayers' interests. Even though the subsidiaries, ventures, and affiliates embedded within a utility holding structure usually maintain distinct identities as legal persons, they act as a single firm that serves the collective economic interests of the parent company's investors and management.

Moreover, it can be difficult for the Staff and other interested parties to untangle and decipher the complicated sequences of transactions within a holding company's complex web of subsidiaries and affiliates. Under accounting and financial conventions, utility companies have much discretion to conduct appraisals of transferred property, dictate the pricing of transfers, select the method of accounting, create sophisticated holding arrangements, and structure complex transactions. As a

²Consumers filed a motion to strike the Staff's reply to exceptions, in which it contends that the reply is not responsive to other parties' exceptions, but rather proposes new modifications to the PFD without an opportunity for other parties to respond. The Commission is not foreclosed from reviewing and modifying the PFD, regardless of whether a party properly briefed its position. It is also not persuaded that the recommendation to delete the pricing provisions is correct on its merits, as discussed in the text of this order.

result, the affiliate dealings disclosed in a utility's periodic reports (and their implications for ratepayers) can be potentially misleading or unclear if taken at face value. Moreover, utility companies often have superior knowledge of the various regulated and unregulated industries in which they operate and superior access to their own financial information. Thus, the Staff or other outside parties are at a considerable disadvantage when they attempt to audit the transactions or investigate affiliate dealings.

Viewed from this perspective, asymmetrical pricing is an additional layer of protection that counteracts the reverse asymmetry implicit in a holding company's normal incentive to understate the resources transferred from a regulated public utility to an unregulated affiliate. In some cases, it may correct actual biases concealed in the company's methods of accounting for and reporting the transactions. On balance, it is the Commission's judgment that the pricing guidelines improve the accuracy of a utility's financial information as they affect public utility regulation.

As indicated by Consumers, the legal status of the pricing provisions of Guidelines 6 and 7 has been in dispute since the decision in Midland Cogeneration Venture Ltd Partnership v Public Service Comm. The Commission agrees with the Staff that the pricing provisions continue to have value as a regulatory standard. The Commission's statutory authority to decide the ratemaking consequences of affiliate transactions is beyond serious dispute. Moreover, the Commission is not persuaded that the pricing provisions are as limited in effect as Consumers and some of the other utilities have portrayed them. Therefore, the Commission will not adopt either the PFD's recommendation to delete those provisions or the Staff's proposal to modify the language, but it will approve the text of those provisions substantially as they now are.

In its exceptions, the MSUWC urges the Commission to require public utilities to obtain prior approval of any proposed transaction with an affiliate. To enhance Guideline 6, the MSUWC urges

the Commission to adopt a proposed checklist of requirements, which includes a showing of the transfer's effects on staffing and safety, a demonstration that the pricing and terms of the transaction are reasonable in all respects, an independent appraisal of property, and pricing at the greater of cost or the appraised value.

SEMCO/WPS Corp/UPPCo argue in reply that the Commission does not have authority to require prior approval of an affiliate transaction or otherwise to enforce the MSUWC's proposed checklist. They say that current Guideline 6, as modified in the PFD, is adequate.

It is not necessary to adopt the MSUWC's proposed checklist. Requiring prior approval of every affiliate transfer of property with a fair market value of more than \$100,000 would increase the regulatory burden on public utilities without any showing of concrete benefits that outweigh the additional administrative costs to the utilities and the public. The concerns addressed by the proposed checklist are too far removed from the guideline objectives of improving the detection of cross-subsidization and affiliate abuses and taking appropriate steps to correct them.

The MCTA proposed to modify the current reporting requirements for affiliate transfers by adding to their detail. The MCTA's expanded requirements would include a description of the affiliate, a complete recitation of the compensation and other material terms of the transaction, the fair market value of transferred assets, and the employees affected by the transfer. The transfer of employees is already governed by Guideline 5. Because there has been no showing that the current reporting requirements in Guideline 6 have been inadequate for the Staff and others to obtain the information required to evaluate affiliate transactions, the Commission is not persuaded that Guideline 6 should be amended in accordance with the MCTA's proposal.

e. Proposed new guidelines

1. Affiliate credit arrangements (Guideline 8)

The ALJ recommended adoption of the Staff's proposed Guideline 8, which would require public utilities to report annually credit arrangements that provide financing to affiliates by encumbering or providing recourse against the utility's assets in the event of a default. There were no objections or exceptions. The Commission finds that the proposed guideline should be adopted.

2. Guideline waiver procedure (Guideline 9)

The ALJ also recommended adoption of a guideline proposed by MECA that would enable public utilities to apply to the Commission for waivers of guideline requirements. Under the proposed guideline, the Commission would grant the proposed waiver if it determines that the applicant has shown good cause and that compliance with the requirement would be impractical or unreasonable. In the absence of exceptions, the Commission adopts the waiver procedure as Guideline 9.

3. Definitions (Guideline 10)

NEMA says that the definitions set forth in Staff witness Brian L. Ballinger's testimony should be formally adopted as part of the guidelines. The MCTA proposed a definition of "affiliate" that is similar to Mr. Ballinger's and further proposed definitions for "employee," "fair market value," "functions," "substantial asset," "transfer," and "utility." Consumers opposes adoption of a definitional guideline, arguing that the Staff did not specifically advance its definitions as part of the guidelines and that the proposed definitions are themselves unclear.

The Commission does not agree that all of the definitions proposed by the MCTA should be adopted. Some of the definitions are meant to bolster the MCTA's position that the guidelines

should apply to the telecommunications industry (as discussed later in this order). Others address terms whose meanings do not appear to be controversial.

However, the Commission does agree that the definitions originally proposed by the Staff may be helpful in providing clarity to the terms “affiliate” and “subsidiary,” as they are used in the guidelines. Both are technical words and are susceptible to different meanings in different contexts. Mr. Ballinger testified that he developed his definitions from the Uniform System of Accounts.³ Tr. 225-26. Instead of adopting verbatim the definitions contained in Mr. Ballinger’s testimony, the Commission’s new Guideline 10 will indicate that the terms “affiliate” and “subsidiary” are defined in accordance with the Uniform System of Accounts.

Entities Subject to the Guidelines

As explained in note 1 of this order, only Consumers, SEMCO, and Mich Con are subject to the existing guidelines. No one filed exceptions to the ALJ’s recommendation to extend the guidelines to all utilities that provide electric or gas service subject to 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1), and other Michigan statutes regulating public utilities, including rural electric cooperatives. The Commission agrees with this recommendation.

In deciding that the coverage of the revised guidelines should be expanded, the Commission notes that the initial guidelines were developed to address concerns related to specific activities of Consumers, Mich Con, and SEMCO. In the years since the guidelines were first issued, electric and gas utilities in Michigan have exhibited an increasing interest in pursuing unregulated business ventures and forming affiliates to house those ventures. The Commission’s ongoing experience

³The citations for the Uniform System of Accounts for Major and Nonmajor Electric Utilities and for Major and Nonmajor Gas Utilities are R 460.9001 and R 460.9021, respectively, of the Michigan Administrative Code.

with the issues created by affiliate dealings is the principal reason why this proceeding was started. In light of these heightened concerns, the Commission can see no legitimate reason to exempt any public utility operating in Michigan from the guidelines.

Of course, the time and effort required by any given utility to comply with the guidelines will be roughly commensurate to that utility's involvement in affiliate dealings. Thus, a utility company that involves itself in few, if any, non-utility businesses will not need to devote much effort to complying with the guidelines. On the other hand, a utility that actively pursues a variety of unregulated businesses by forming a complex holding structure will be required to comply with the relatively modest reporting, recordkeeping, and other requirements in the guidelines. For the most part, the accounting requirements are not materially different from those already observed by regulated utilities.

In response to MIPPA's request for a qualifying facilities exemption from the guidelines, the ALJ noted that only public utilities that engage in the local distribution of electricity or natural gas are subject to the guidelines. The ALJ stated that because qualifying facilities do not engage in local distribution, "their concerns would be satisfied." PFD at 24. He did not further address MIPPA's position beyond that observation. In its exceptions, MIPPA reiterates its request for the Commission to state that the guidelines do not apply to qualifying facilities selling their electrical output pursuant to power purchase agreements approved by the Commission. MIPPA's concern is that qualifying facilities that fall within the definition of an affiliate of a public utility will find themselves indirectly subject to the guidelines' requirements relating to accounting and access to records.

Consumers says that there are legal and factual constraints that would inhibit the Commission from subjecting qualifying facilities to the guidelines, but that it is not necessary to issue a ruling that defines those constraints at this time.

The Commission agrees with the ALJ that qualifying facilities whose activities are restricted to selling electricity on a wholesale basis are not subject to the guidelines as public utilities. However, it is not clear why a qualifying facility that is also an affiliate of a public utility should be treated differently under the guidelines than any other type of affiliate. The Commission declines to address this issue further at this time.

In its exceptions, the MCTA takes the position that the guidelines should cover telecommunications providers that are also incumbent local exchange carriers. Anticipating an objection that the scope of this case does not include telecommunications, the MCTA notes that the March 8, 1999 order commencing this case provided notice that the Commission would “decide whether to expand or reduce the list of entities to which these requirements should apply.” Order at 2. The MCTA contends that the objectives of protecting against cross-subsidization and curbing market power are as relevant in the context of the telecommunications industry as in the energy industries. The MCTA argues that various provisions of the Michigan Telecommunications Act, MCL 484.2101 et seq.; MSA 22.1469(101) et seq., authorize the Commission to pursue the same objectives as those underlying the guidelines.

Although affiliate dealings in the telecommunications industry are in many respects similar to the energy industries, the Commission is not persuaded that guidelines developed for electric and gas utilities are necessarily transferable to telecommunications providers. In the first place, telecommunications providers are subject to a different scheme of statutory regulation that provides different means of recourse for abuses of affiliate relationships. Moreover, telecommunications is

beyond the scope of this case. The March 8, 1999 order may not have explicitly excluded telecommunications from its scope, but only because the Commission did not anticipate that anyone would propose to apply the guidelines in that context.

Procedural Rulings

Most of the disputed procedural rulings relate to the ALJ's definition of the scope of these proceedings. The ALJ's rulings based on his reading of the March 8, 1999 order and notice of hearing precluded several parties from obtaining the discovery they sought and from submitting testimony regarding their proposed changes to the guidelines. In response to two of the rulings, parties filed applications for leave to appeal. First, MAFC, ABATE, and Fiber Link sought to appeal the ALJ's May 19, 1999 ruling denying their requests to compel discovery. In that ruling, the ALJ concluded that the proceedings envisioned in the March 8, 1999 order dealt with the guidelines as a generic matter and therefore excluded a detailed exploration of the utilities' past affiliate dealings and their history of compliance with the existing guidelines. Tr. 69-75. Second, MAFC filed an application for leave to appeal the ALJ's June 24, 1999 ruling striking most of the prefiled testimony of a witness it proposed to sponsor. The reason given for the ruling was similar to the earlier ruling—that the testimony placed too much emphasis on prior transactions. Tr. 85-86.

In addition, NEMA excepts to the ALJ's ruling striking testimony it attempted to sponsor. NEMA argues that the ALJ erred in determining that the testimony surpassed the scope of the case by proposing requirements that are more properly classified as part of a code of conduct. NEMA argues that the record should have included its proposals for controlling affiliate dealings, including the enforcement mechanisms that it proposed.

In their exceptions, ABATE and MAFC argue that the ALJ improperly restricted the development of the record by adopting an unduly narrow definition of the scope of the case. They argue that the ALJ erred in viewing the guidelines' function as limited to imposing reporting requirements and in denying them an opportunity to propose new requirements that would prevent utilities from abusing their relationships with affiliates. ABATE and MAFC contend that the record should have addressed whether it is necessary to make the guidelines more effective in light of past misconduct. In light of the ALJ's rulings, they contend, the present record does not provide a basis for making meaningful changes, and the case should be remanded for further hearings.

In their replies to the exceptions, Consumers, SEMCO/WPS Corp/UPPCo, and Mich Con argue that the ALJ set appropriate limits on the proceedings. Consumers and Mich Con add that the Commission does not have statutory authority to adopt some of the requirements that the parties proposed.

The Commission finds no error in the ALJ's procedural rulings, including those specifically addressed in the applications for leave to appeal and the exceptions. The ALJ correctly recognized that the order commencing this case was not intended to grant an unlimited license to advocate measures that are tangential to the objectives of the guidelines. The Commission intended that the guidelines would provide an effective mechanism for identification and disclosure of affiliate transactions that pose difficult regulatory issues. On balance, the record developed under the ALJ's direction was adequate for the Commission to resolve its concerns that the guidelines were becoming outdated in some respects. This order updates the guidelines in light of contemporary developments. It further extends the guidelines to embrace all of the public utilities that are subject to the Commission's jurisdictional oversight. The Commission is not persuaded that adopting a more expansive definition of the case would have altered its ultimate determinations.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; MSA 22.151 et seq.; 1909 PA 300, as amended, MCL 462.2 et seq.; MSA 22.21 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACCS, R 460.17101 et seq.

b. The guidelines for transactions between public utilities and their affiliates should be amended as set forth in Exhibit A attached to this order.

c. The guidelines for transactions between public utilities and their affiliates should apply to all public utilities that provide electric or natural gas service subject to the statutory authority of the Commission.

THEREFORE, IT IS ORDERED that:

A. The guidelines for transactions between public utilities and their affiliates shall be amended as set forth in Exhibit A attached to this order.

B. The guidelines for transactions between public utilities and their affiliates shall apply to all public utilities that provide electric or natural gas service subject to the statutory authority of the Commission.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ John G. Strand

Chairman

(S E A L)

/s/ David A. Svanda

Commissioner

/s/ Robert B. Nelson

Commissioner

By its action of May 3, 2000.

/s/ Dorothy Wideman

Its Executive Secretary

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

Chairman

Commissioner

Commissioner

By its action of May 3, 2000.

Its Executive Secretary

In the matter, on the Commission's own motion,)
to consider changes to its guidelines for)
transactions between affiliates.)
_____)

Case No. U-11916

Suggested Minute:

“Adopt and issue order dated May 3, 2000 amending the Commission's guidelines for transactions between affiliates, as set forth in the order.”

GUIDELINES FOR TRANSACTIONS BETWEEN AFFILIATES

These guidelines apply to all public utilities that provide electric or natural gas service subject to the statutory authority of the Michigan Public Service Commission.

1. The utility shall ensure that the Commission has access to books and records of the holding company and each of its affiliates and their joint ventures. Any objections to providing access as requested under this guideline must be raised before the Commission, and the burden of showing that the request is unreasonable or unrelated to the proceeding is on the party seeking to deny or withhold access.
2. Each utility, holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its 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-utility activities by the utility's customers.
3. The holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall keep their books in a manner consistent with general accounting principles and, where applicable, consistent with the Uniform System of Accounts.
4. The utility shall furnish the Commission with:
 - a. Consolidated 10K reports and shareholders' reports of the consolidated utility and/or its parent holding company on an annual basis;
 - b. Annual reports concerning the utility's intercompany transactions. The report shall provide a specific explanation of the nature of each transaction and a specific description of the basis for the cost allocations and transfer pricing established in each transaction;
 - c. Annual balance sheets and income statements of the non-regulated subsidiaries of the utility and/or the non-consolidated subsidiaries of the holding company;
 - d. Reports of internal audits conducted regarding transactions between the utility and its non-utility affiliates, which shall be submitted with the annual report for the year 2000 and with subsequent annual reports due at the end of each third year following 2000. The audit report shall address transactions occurring since the last audit report and shall determine whether appropriate cost allocation procedures and transfer pricing methodologies were followed and whether the utility and its affiliates are maintaining records that are adequate to facilitate an effective audit of the transactions. The Commission Staff may require more frequent reports or conduct additional audits when appropriate;

- e. Copies of federal income tax returns, whether on a consolidated or non-consolidated basis, need not be submitted to the Commission, but they shall be available to the Commission for inspection and review at the utility's Michigan business office.
5. The utility shall avoid a diversion of management talent that would adversely affect the utility. An annual report identifying employees transferred from the utility to non-utility subsidiaries is required. The report shall provide the name of each employee, the employee's former function or department within the utility, and the function or department of the subsidiary to which the employee was transferred.
6. The utility shall notify the Commission in writing within thirty days prior to any transfer to non-utility affiliates of any utility assets or property exceeding a fair market value of \$100,000. At the time that notice is provided, the utility shall make available to the Commission information that demonstrates how the transfer price was determined. Asset transfers from regulated to non-regulated shall be at the higher of cost or fair market value and non-regulated to regulated shall be at the lower of cost or fair market value. All services and supplies provided by non-regulated enterprises shall be at market price or 10% over fully allocated cost, whichever is less.
7. Market, technological, or similar data transferred, directly or indirectly, from the utility to a non-utility affiliate shall be transferred at the higher of cost or fair market value.
8. In its annual report, each utility shall provide information on any arrangement that allows an affiliate to obtain credit in a manner that permits a creditor, upon default, to have recourse to or in any way encumber the utility's assets.
9. A utility may file an application for a waiver from any provision of these guidelines. The application shall demonstrate the basis for the waiver. The Commission, in deciding the application, may consider the costs and benefits of compliance. For good cause shown, the Commission may grant the waiver if compliance is determined to be impractical or unreasonable under the circumstances.
10. For purposes of applying these guidelines, "affiliate" and "subsidiary" shall have the same meanings as the definitions provided for "associated companies," and "subsidiary company," respectively, in the Uniform System of Accounts for gas and electric utilities, which are adopted by Commission rule. Other words defined in the Uniform System of Accounts that are used in the definitions of "associated companies" and "subsidiary company" (e.g., "control") shall also retain their defined meanings. (See R 460.9001, R 460.9021.)