Transactions with Affiliates

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Allocations Between Affiliated Entities

- All the large utilities in Maine are subsidiary of a much larger entity, sometimes referred to as a holding company, which operate other companies as well
- Other companies are both regulated and non-regulated
- Allocations are important as there is an incentive to shift costs to regulated entities where recovery may be more likely which would result in increased profits for the non-regulated entities

Allocations between Affiliated Entities

- Regulated entities may operate in different states and be subject to regulation by other state utility commission’s or federal regulatory agencies
- Non-regulated entities not subject to regulation and likely riskier endeavors
- Holding companies and service companies that operate in multiple states subject to the regulations of the Federal Energy Regulatory Commission (FERC) – Title 18 CFR Part 366
- Regulations are designed to prevent “cross-subsidization” – one entity paying for costs that actually benefited another entity
- Cross-subsidization can occur between regulated entities as well as between regulated and non-regulated entities

Allocations between Affiliates

- Many administrative functions (accounting, legal, regulatory) performed by one central group for all affiliates
- Allocations necessary to ensure that regulated entity pays its fair share of “common costs” but does not subsidize other affiliates
- Regulations require costs to be direct charged, meaning charged only to one entity, as much as possible – for example outside contractors should be contracted for by entity and required to break bills down by entities and not charge one large bill
- Costs not direct charged are considered indirect costs and any allocation method used must have a relationship with the cost – heating costs of a building that houses different affiliates could be allocated based on square footage occupied by each affiliate

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Allocations between Affiliates

- If direct causation cannot between determined, than other allocations tools would be necessary
- Other allocation basis:
  - Massachusetts formula which weights revenues, plant in service, number of customers
  - Number of employees
  - Payroll costs
  - Total direct charged expenses
- If subject to FERC regulations, changes in allocation basis subject to review
- FERC conducts audits of service companies and allocation methods

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Allocations Between Affiliates

- Service companies use a Uniform System of Accounts (USofA) initially formulated under SEC regulations from Public Utility Holding Company Act of 1935 – FERC continues to use this system under the Public Utility Holding Company Act of 2005
- Use of USofA helps comparability of costs
- Service companies under FERC jurisdiction submit Form No. 60 annually
- Service companies are not-for-profit and all costs are allocated out to affiliated companies, including the parent company
- Parent company should be charged for portion of certain of administrative costs plus all costs associated with growing business through possible acquisition of other entities

Affiliate Transaction Approval by MPUC

- 35-A M.R.S. §707(3) requires the approval of essentially any contract between the regulated entity and its affiliates, including service companies and parent company
- Statutes allow for a total review period of 120 days
- Statute requires Commission to find “that the contract or arrangement is not adverse to the public interest”
- Areas of review to make determination:
  - What service is being received and could it be provided by a non-affiliated entity – for example, legal services related to internal operations likely could not be contracted out for only one affiliate

MPUC Review of Affiliated Transactions – Areas of Review

- Was the affiliate selected after a competitive bid process or was the affiliate a sole source provider
- How does the utility verify that the costs charged are for services received and the agreed upon price? If service is "at cost", how does the utility verify that the cost is reasonable and not excessive?
- Does the contract allow the utility to question the charges, either whether the service was received or the cost of the service?
- If contract is for a service that is regulated by FERC and has a tariffed rate, the Commission can approve whether the affiliate enters the agreement and the level of service but not the rate.

Determining Reasonableness of Costs

- One way to determine if a cost is reasonable is to benchmark it to costs incurred for similar services
- Benchmarking between utilities is possible because the utilities use the same USofA allowing comparability
- One could also compare costs between years and obtain explanation for fluctuations that are not apparent (increased per unit fuel costs would result in increased total expense even if use stayed static)
- Should try to compare to entities of similar size – for instance, one investor owned water utility is required to compare the total managerial costs incurred from parent to the managerial costs incurred by stand-alone utilities that serve a similar number of customers

Accounting Protocols

- Used to determine how costs are to be recorded within one utility
- Also used to determine how to allocate costs between divisions and/or functions
- Allocation of all costs allows utility (or any entity) to determine cost of providing particular service and also profitability
- Allocations also prevent cross-subsidization between divisions
  - Utility decides to provide service in a new area and is allowed to do so but is not allowed to charge current customers any costs related to new service (Loring Accounting Protocols)
  - Should have set procedures to allocate all costs
  - Should be set up before costs are incurred to reduce having to use recall to determine why a charge was incurred