STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	:	
	:	
Verified Petition for Declaratory	:	**Docket No. 03-0496**
Ruling or in the Alternative,	:	
Application for Approval of Affiliated	:	
Interest Contract.	:	

INITIAL BRIEF OF MIDAMERICAN ENERGY COMPANY

NOW COMES MidAmerican Energy Company ("MidAmerican") and files its Initial Brief in this proceeding pursuant to the briefing schedule established at the evidentiary hearing held on July 14, 2005 [Tr. 97] and 83 Ill. Admin. Code §200.80.

STATEMENT OF THE CASE

MidAmerican is a vertically-integrated, investor-owned, multi-state public utility providing bundled and unbundled retail and wholesale electric service. MidAmerican provides electric retail public utility service in the states of Iowa, Illinois, and South Dakota. [MEC Exh. 1.0 at ll. 88-89]. The electric energy sold by MidAmerican is produced, transmitted and distributed using equipment owned by MidAmerican.[1] Most of the electric energy produced by MidAmerican's generators is sold to retail customers in the State of Iowa.

MidAmerican's ultimate parent holding company, MidAmerican Energy Holdings Company ("MidAmerican Holdings"), is also in the business of producing electric energy through its business platforms CalEnergy-Domestic and CalEnergy-International

[1] Traditionally, MidAmerican has met its needs for electric capacity by constructing, owning and operating electric generation facilities. MidAmerican owns and operates over 4,000 MW of electric generation capacity dedicated to serving regulated customers in Iowa, Illinois and South Dakota. [MEC Exh. 1.0 at ll]. 85-89; MEC Exh. 1.5]. In addition to the generating capacity it presently owns and operates, MidAmerican has three major electric generation projects in development. [MEC Exh. 1.0 at ll. 279-293; MEC Exh. 1.5]

(collectively, "CalEnergy"). Through these platforms, MidAmerican Holdings has constructed and owns and operates 19 generating plants – 15 in the United States and four in the Philippines. [MEC Exh. 1.0 at ll. 304-354]. Neither CalEnergy nor MidAmerican Holdings is a public utility and have no interests in transmission or distribution equipment beyond equipment required to connect generation to the transmission grid.

In 1999, MidAmerican Holdings conducted a solicitation for acquisition of electric turbine generators. [MEC Exh. 1.0 at ll. 125-154]. Through this competitive process, it was determined that there were three potential vendors of large, utility-size 60 cycle turbines suitable for use in combined cycle combustion turbine generators – ABB, General Electric ("GE") and Siemens-Westinghouse. [MEC Exh. 1.0 at ll. 128-131]. Of the three potential vendors, two were determined to be unavailable or unacceptable to meet MidAmerican Holdings' needs. GE did not submit a bid because it had a backlog. [MEC Exh. 1.0 at ll. 136-137]. ABB did not supply turbines separately from an entire combined cycle generating unit and also had reported quality problems. [MEC Exh. 1.0 at ll. 131-136]. That left only Siemens-Westinghouse with the ability to deliver a combustion turbine generator to MidAmerican Holdings prior to 2003. This solicitation resulted in the acquisition by MidAmerican Holdings for its CalEnergy business platforms of two turbine generators pursuant to a contract referred to as "Contract for Two 501F Combustion Turbine Generator Econopacs Cordova #2 between MidAmerican Energy Holdings Company and Siemens Westinghouse Power Corporation ("Turbine Contract") [MEC Exh. 1.4]. After negotiation, the Turbine Contract was signed by MidAmerican Holdings on May 26, 2000. [MEC Exh. 1.0 at ll. 145-146].

As part of its ongoing generation planning process, MidAmerican conducted a load and capability study in 2001. [MEC Exhs. 1.1 and 5.1]. This study indicated several contingencies that could result in the need for generation by the summer of 2003. These contingencies were:

- MidAmerican's demand was increasing 70 MW per year [MEC Exh. 1.1 at p. 1].
- Given that level of demand increase, if hot weather conditions were experienced, MidAmerican would have only 6 MW above required capacity reserves [MEC Exh. 5.1 at Att. 2.1].
- In the event of extreme weather, demand would outstrip capacity and minimum required reserves by 255 MW [*Id.*]
- The total capacity provided by two purchase power contracts expiring in 2004 was uncertain because one of the purchase contracts was with a nuclear unit that had experienced a number of operating problems, which could exacerbate a capacity shortage situation in the event of peak demand [MEC Exh. 5.0 at ll. 108-109; 135-155; fn. 1 on p. 7].

In addition to the need for generation evidenced by results of the load and capability study, MidAmerican was experiencing a need for location of in-system generation to address system reliability considerations. The Des Moines, Iowa area, MidAmerican's load center, relies on the transmission system to supply electric energy. From time to time, these facilities are limited by line outages, power transfers and other system conditions. [MEC Exh. 5.0 at ll. 278-284]. During 2001 [the time period in which it was determined to construct the Greater Des Moines Energy Center ("GDMEC") to meet MidAmerican's needs for capacity] the Des Moines area experienced various transmission loading relief events. [MEC Exh. 5.0 at ll. 170-179]. In addition to the specific events impacting the MidAmerican system, there were general industry concerns about the status of American transmission infrastructure. [MEC Exh. 5.0 at ll. 180-244].

One way to support transmission is to build generation close to the load, instead of relying on transmission that can become overloaded to deliver power to an area. In addition, to an extent, locating generators in proximity to one another helps accelerate recovery time for system restorations in the event of regional blackout. [MEC Exh. 5.0 at ll. 292-317]. GDMEC is located immediately adjacent to the Pleasant Hills Energy Center ("PHEC"). [MEC Exh. 5.0 at ll. 293-295]. Locating the two units close to one another is beneficial to MidAmerican's major Des Moines load center. In the event of a regional disruption, the Des Moines area would otherwise have to wait until generation units in Sioux City and Council Bluffs were started in order to service to be restored. [MEC Exh. 5.0 at ll. 311-312].

All of these factors led MidAmerican to strongly consider locating the needed generation close to the Des Moines load center. To comply with then-current Iowa law, MidAmerican began to conduct a request for proposal process ("RFP"). [MEC Exh. 5.0 at ll. 513-516]. However, the RFP was cancelled when there was a major change in Iowa law when H.F. 577 was enacted, which made two major changes in Iowa law regarding electric generation built in the state. First, H.F. 577 repealed the requirement that electric generation built in Iowa be the least cost option as long as a utility had an energy efficiency plan in place. [MEC Exh. 1.0 at ll. 111-114; MEC Exh. 5.2 (Testimony of J. Graves at p. 6, l.16 - p. 7, l. 3]. *Iowa Code* §§ 476.53c.(1), 476A.6(2005). Second, the legislation provided an advance review and determination of the ratemaking treatment to be applied to generation and transmission investments when reflected in Iowa rate-regulated utilities. *Iowa Code* §476.53 (2005). This process allowed for determination of ratemaking principles to be in effect for the life of the plant. [MEC Exh. 1.0 at ll. 112-

114]. The Iowa legislature did not extend the same process or ratemaking principles to purchase power contracts and non-Iowa generation. *Iowa Code* 476.53 (2005). Given the change in the law, MidAmerican was concerned it would not receive realistic bids and that its future credibility might be harmed if it were to proceed with an RFP, when a state preference for Iowa-based generation had been made clear. [MEC Exh. 5.0 at ll. 513-516].

In place of an RFP, in 2001, MidAmerican conducted an investigation of the appropriate manner by which to satisfy its need for generating capacity by 2003. MidAmerican retained Dr. Joseph S. Graves, an engineering and economic consultant with over 23 years of experience providing strategic planning advice on energy and natural resources issues to clients in the public and private sectors. Dr. Graves' analysis submitted to the Iowa Utilities Board is included in the record as MEC Exh. 5.2. Dr. Graves compared GDMEC to a number of options: (1) a single cycle combustion turbine; (2) a coal-fired unit; (3) wind generation with purchase power agreement supplement; and (4) a long-term power purchase agreement. GDMEC had a clear advantage over all of these alternatives. [MEC Exh. 5.0 at ll. 392-397; MEC Exh. 5.2, Dr. Graves' testimony at pp. 8-15; 21].

In order to ensure 2003 needs could be met cost-effectively and on a timely basis, Mr. Crist, who was the vice president responsible for procuring adequate generation to meet MidAmerican's needs, analyzed methods of procuring the needed generation resources. [MEC Exh. 1.0 at ll. 6-15; MEC Exh. 1.1]. Mr. Crist conducted an independent analysis of options. He determined that the market for and availability of turbines had not changed since 1999 – that neither ABB nor GE turbines would be

suitable or available by 2002 for installation in a unit scheduled to go on line in 2003. [MEC Exh. 1.0 at ll. 157-161, MEC Exh. 1.2]. Therefore, he determined that Siemens-Westinghouse turbine generators were the only available to meet the requirements of GDMEC. *Id.* Mr. Crist's determination has been supported by the testimony of the two independent experts who have testified in this proceeding. [MEC Exhs. 3.0 and 4.0].

Upon the review and analysis of generation options described in Mr. Crist's testimony, on July 21, 2001, MidAmerican took assignment of the Turbine Contract ("Turbine Assignment"). [MEC Exh. 1.2]. The turbines were acquired by MidAmerican for $22,011,262.70, which consisted of reimbursement to MidAmerican Holdings of the amounts that it had paid Siemens Westinghouse for the turbines at the time of the transfer. [*Id.* at 2]. The assignment bound MidAmerican to pay all remaining amounts due under the Turbine Contract.

The total price ultimately paid by MidAmerican for the two turbines as a result of assignment of the Turbine Contract was $77,684,551, which includes the reimbursements to MidAmerican Holdings, payments to Siemens-Westinghouse after the transfer and associated technical assistance and sales tax costs of $5,947,843. [MEC Exh. 2.0 at ll. 47-51]. The cost per turbine net of sales tax and associated technical assistance was approximately $36 million. [*Id.*] The first phase (simple cycle operation) of GDMEC was constructed and began commercial operation prior to the summer of 2003. [MEC Exh. 1.0 at ll. 282-287].

PROCEDURAL HISTORY

MidAmerican believed the Turbine Assignment to be a transaction in the ordinary course of business for the purchase of personal property made at or below standard or

prevailing market prices with Illinois Commerce Commission ("Commission") consent waived pursuant to 83 Ill. Admin. Code §310.60(b). In order to confirm this understanding, on August 19, 2003, MidAmerican filed with the Commission its verified petition for declaratory order, or in the alternative, an application for approval of an affiliated interest contract with the Commission. In its Petition, MidAmerican sought a declaratory ruling that its acquisition of the two Siemens-Westinghouse combustion turbine generators from its ultimate parent holding company was exempt from approval by the Commission pursuant to Section 7-101(3) of the Illinois Public Utilities Act ("Act"), 220 ILCS 5/101 et seq.

In its Interim Order issued in this proceeding on January 7, 2004, the Commission determined it was not able to conclude with certainty that the Turbine Assignment was entered into in the ordinary course at a price not exceeding the standard or prevailing market price. [*Interim Order*, ICC Docket No. 03-0496, January 7, 2004 at p. 8]. The Commission was unable to make such a determination for two reasons. First, it determined that as an affiliated interest transaction, closer review was warranted. [*Id.*] Second, the Commission was not prepared to conclude that the purchase price was a standard or prevailing market price, finding that MidAmerican's experts should be asked specifically about the feasibility of turbines other than the Siemens-Westinghouse model and their pricing and suitability for GDMEC. [*Id.*] Therefore the Commission determined to conduct a second phase of the proceeding to determine whether the turbine transfer was in the public interest as required under Section 7-101(3) of the Act.

Direct, rebuttal and surrebuttal testimony has been filed in this proceeding by MidAmerican. Direct and rebuttal testimony has been filed by Staff. On April 7, 2005,

Staff filed a motion to strike a portion of MidAmerican's surrebuttal testimony which advised the Commission that, as a result of the Staff position, MidAmerican would not be allocating new utility-owned generation and long-term power purchases to Illinois. Staff's Motion was granted on June 13, 2005. A hearing was held in this proceeding on July 14, 2005, and the record was marked "heard and taken."

LEGAL AUTHORITIES

I. The "public interest standard" applies to Commission consent under Section 7-101(3) of the Act

Under Section 7-101(3) of the Act, the Commission must consider whether the Turbine Assignment was entered into in the public interest:

> No management, construction, engineering, supply, financial or similar contract and no contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission or is exempted in accordance with the provisions of this Section or of Section 16-111 of this Act. The Commission may condition such approval in such manner as it may deem necessary **to safeguard the public interest**. If it be found by the Commission, after investigation and a hearing, that any such contract or arrangement is not in the public interest, the Commission may disapprove such contract or arrangement. [Emphasis supplied].

A comprehensive definition of **"**public interest" as used in Section 7-101(3) has not been articulated by either the Commission or the courts. However, other sections of the Act apply a similar standard to Commission approvals and authorizations. For example, Section 7-102 of the Act provides at Subsection 7-102(C) that the Commission has the authority to consent to public utility mergers if the "…public will be convenienced thereby…." This section has been interpreted by the Supreme Court to give the Commission "…broad discretion to decide whether a proposed transaction should be

approved…." *Illinois Power* et al. *v. Illinois Commerce Commission*, 111 Ill. 2d 505, 511; 490 N.E. 2d 1255, 1257 (1986). The Court found the Commission's broad discretion to be appropriate given the wide variety of transactions it could be required to consider under Section 7-102:

> The legislature, apparently recognizing that it would be impractical to attempt to provide precise criteria to be considered in every transaction regulated under section 27, gave the Commission broad discretion to decide whether a proposed transaction should be approved when it set "public convenience" as the standard for approval….

Illinois Power, 111 Ill. at 511; 490 N.E. 2d at 1257, citing *Chicago & North Western Ry. Co. v. Illinois Commerce Com.*, 130 Ill. App. 2d 352, 361, 264 N.E. 2d 745, 361-362 (1st Dist. 1970).

Consistent with notion of broad discretion is a flexible and expansive review of all potentially relevant facts and circumstances surrounding the Turbine Assignment. If the Commission does not rule that the Turbine Assignment was entered into in the ordinary course of business at a market price, with approval waived pursuant to 83 Ill. Admin. Code §310.60(b), a broad review of all potentially relevant facts and circumstances of the transaction should be undertaken. The Commission is not bound by any prior decision as controlling precedent in making its determination, but instead should make its determination based on the unique facts presented in this case, which clearly demonstrate that construction of GDMEC was a reasonable way for a utility with multi-state operations based primarily in Iowa to meet its needs for a reliable supply of electric capacity.

II. "Public interest" is interchangeable with "public convenience"; the "public convenience" standard is a flexible one that is dependent upon the facts and circumstances of each case and the situation of each utility

In *Illinois Power*, the Supreme Court equated "public convenience" and "public interest, suggesting they are interchangeable. *Illinois Power*, 111 Ill. at 511; 490 N.E. 2d at 1257. Just as the Supreme Court in *Illinois Power* determined the "public interest" standard to be flexible and impossible of definition via precise criteria, the courts consider the "public convenience and necessity" standard to be "…a relative concept" and dependent upon the fact and circumstances surrounding each utility:

> The doctrine of public convenience and necessity is a relative concept, rather than a matter of fixed or absolute rule, and thus it has long been established that the determination of whether the public convenience and necessity require a particular service of a public utility to be performed, dispensed with, or curtailed, must depend upon the particular facts of each case.

Municipality of Princeton v. Illinois Commerce Commission,17 Ill. App. 3d 812 at 821; 308 N.E.2d 625 at 631 (1st Dist. 1974), citing *Gardner v. Commerce Co.*, 400 Ill. 123at 137, 79 N.E. 2d 71 at 78 (1948). The explicit recognition of the court in *Illinois Power* that the better-defined "public convenience" standard is interchangeable with the "public interest" standard further supports a flexible review of the evidence in this proceeding. This review should be consistent with the articulated definition of "public convenience and necessity" – one that considers the "facts and circumstances of each individual …utility." This standard suggests that **if** the Commission should determine it needs to venture beyond a simple review of the reasonableness of the price paid by MidAmerican for the Turbine Assignment to undertake an analysis of whether GDMEC was MidAmerican's least cost investment, as Staff argues, it should not limit its focus to only

one analytical method. In other words, more than one methodology is reasonably used in order to fulfill the public convenience and necessity.

III. Application of an "after the fact" analysis to GDMEC would be arbitrary and capricious

Staff's position in this proceeding is rigid. Staff witness Rockrohr contends that MidAmerican should have presented the results of an RFP demonstrating that GDMEC was its least cost generation option in order to secure Commission consent to the Turbine Assignment. [Staff Exh. 1.0 at ll. 61-84]. Mr. Rockrohr, while not an attorney, appears to base his position that an RFP is a required and mandatory first step to a generation investment on the Commission's decision in *Interstate Power Company,* "Application for Approval of Affiliated Interest Contracts", ICC Docket No. 02-0571. *Interstate* is **not** precedent for the Turbine Assignment. Interstate's Petition in Docket No. 02-0571 was filed on September 6, 2002 – almost a year **after** MidAmerican entered into the Turbine Assignment on July 21, 2001. [MEC Exh. 1.2]. The Commission's decision in *Interstate* was issued on March 18, 2003, almost two years after MidAmerican's decision to acquire the turbines.

Staff is attempting, using hindsight, to hold MidAmerican to an "after the fact" standard of review. Staff's argument that MidAmerican can only demonstrate that the Turbine Assignment was in the public interest by conducting an RFP is very similar to the argument made by Staff witnesses in *Illinois Power Company v. Illinois Commerce Commission,* 339 Ill. App. 3d 425; 790 N.E. 2d 377 (1st Dist. 2003) ["*Illinois Power II"*] In that case, based on Staff testimony, the Commission ruled that Illinois Power had not acted prudently when it retired a propane plant because the retirement was not preceded by a present value of revenue requirements ("PVRR") analysis. The Appellate Court

held that "prudency" was not a rigid standard but instead that "…reasonable persons can have honest differences of opinion without one or the other necessarily being 'imprudent'." *Illinois Power II,* 339 Ill. App. 3d at 384; 790 N.E. 2d at 435, citing *Illinois Commerce Commission v. Commonwealth Edison Co*., 1987 Ill. PUC LEXIS 68, Ill. Commerce Commission Op. 84-0395. The Court declined to uphold the Commission's requirement for a PVRR analysis, calling its decision arbitrary and the creation "after the fact" of a standard of care that was applied by the Commission using hindsight. *Illinois Power II* 339 Ill. App. 3d at 388; 790 N.E. 2d at 439-440.

It would be equally arbitrary to hold MidAmerican to a standard that had not previously been applied by the Commission. At the time it entered into the turbine assignment, it was impossible to foresee that the Commission would approve the Interstate turbine transfer, noting that it was based on the results of an RFP. Holding MidAmerican to a standard established almost two years after it made its significant decision is not only arbitrary but would deny MidAmerican due process of law and should be rejected by the Commission.

IV. Requiring an RFP interferes with MidAmerican's ability to operate as a multistate utility in interstate commerce

Finally, Staff's position interferes with MidAmerican's ability to operate as a multi-state utility in interstate commerce. In addition to the constitutional infirmity of denying MidAmerican its due process of law, reliance on an RFP as the sole manner in which to prove that a generator is the least cost investment violates the Commerce Clause of the U.S. Constitution. MidAmerican is a multi-state utility, serving primarily customers in Iowa. By enacting H.F. 577, the State of Iowa has articulated a strong state

policy of encouraging Iowa-based, state-rate regulated electric generation over purchase power contracts. *Iowa Code* Subsection 476.53(1) (2005) enunciates this policy clearly:

> It is the intent of the general assembly to attract the development of electric power generating and transmission facilities **within the state** in sufficient quantity to ensure reliable electric service to Iowa consumers and provide economic benefits to the state. [Emphasis supplied].

Additionally, *Iowa Code* Subsection 476.53(4)(2005) provides advance ratemaking treatment for utility-based generation that is not available for a purchase power contract. Staff's insistence on an RFP as the sole way to demonstrate need and its suggestion that MidAmerican should have leased a generator from a third party or extended a purchase power contract instead of constructing GDMEC is inconsistent with the state policy articulated above. To require MidAmerican to comply with an RFP process and consider a purchased power contract would interfere with its ability to conduct business in two states, including the state in which it is primarily domiciled. Conflicting regulatory requirements such as those imposed by the State of Iowa and those suggested by Staff were one of the reasons why the Illinois Supreme Court struck down Illinois' state regulatory authority over securities as violating the Commerce Clause of the U.S. Constitution in *United Air Lines, Inc. v. Illinois Commerce Commission,* 32 Ill. 2d 516; 207 N.E.2d 433 (1965). Staff's proposed position would similarly prevent MidAmerican from operating freely in multiple states and jurisdictions across state lines and should be rejected by the Commission.

ARGUMENT

I. The Turbine Assignment was entered into in the ordinary course of business at a market price and Commission consent of the affiliated interest transaction is not required under Section 7-101(3)

In the Interim Order, the Commission determined not to waive the filing and necessity for approval of the Turbine Assignment under 83 Ill. Admin. Code §310.60(b) as a contract entered into in the ordinary course of business for the purchase of personal property at a price not exceeding the standard or prevailing market price. Instead, given the "…closer review warranted by affiliate transactions" it was determined to proceed to full review of the Turbine Assignment in this phase of the proceeding. *Interim Order* at 8.

Based on the evidence that has been presented, it is now timely for the Commission to revisit its earlier determination and waive approval of the Turbine Assignment under 83 Ill. Admin. Code §310.60(b). MidAmerican has satisfied both of the prongs of the "ordinary course" exception to Commission consent to affiliated interest transactions under Section 7-101(3) of the Act. MidAmerican has demonstrated that the Turbine Assignment was entered into in the ordinary course of business – both MidAmerican and CalEnergy are recognized in the industry as constructors and operators of electric generation equipment such as turbines – and that the price paid by MidAmerican was undisputedly at or below the standard or prevailing market price.

A. MidAmerican and CalEnergy are in the business of constructing, purchasing, operating and maintaining electric generation equipment such as turbine generators

The testimony of Mr. Crist describes the businesses of CalEnergy and MidAmerican. CalEnergy has significant national and international interests in power generation, including 15 plants in the United States and 4 in the Philippines. [MEC Exh. 1.0 at ll. 304-354]. MidAmerican owns and operates over 4,000 MW of power plants and is presently constructing two new plants in addition to GDMEC – a 790 MW coal-fired

unit and a 310-MW nameplate wind farm. [MEC Exh. 1.0 at ll. 276-300]. Acquisition of electric generation equipment is a significant part of the business of both companies and thus is part of their ordinary course of business.

Staff witness Rockrohr concludes that MidAmerican has not regularly acquired generators and thus acquisition of the turbines is not part of the ordinary course of its business. [Staff Exh. 1.0 at ll. 140-145]. He does not state what he would consider to be the interval for acquisition of generation equipment that would bring a utility within the ordinary course. He appears to acknowledge that MidAmerican constructed a generator in 1984; a combustion turbine generator in 1988; another combustion turbine in 1993; and GDMEC in 2001 [Staff Exh. 1.0 at ll. 140-148], but does not indicate why this history does not demonstrate the ordinary course of business. He does not provide any indication of what interval he would consider in the ordinary course that a utility could use for future guidance.

Such a conclusion ignores MidAmerican's significant and ongoing generation activities and the manner in which they are conducted. CalEnergy and MidAmerican not only construct new generation, they also maintain and operate that generation equipment, which means they are continually acquiring replacement parts, and retiring used generation equipment. In addition, Mr. Rockrohr's suggestion that MidAmerican has acquired turbines on occasions that are too far apart to constitute the ordinary course of business fails to consider that generation must be constructed in response to customer demand and system reliability needs and is added in blocks of capacity at discrete times not in small increments on an annual or regular basis.

Mr. Rockrohr also fails to recognize that MidAmerican has ramped up its generation construction business since passage of H.F. 577. Since its enactment, MidAmerican has proceeded to construct a 790 MW coal-fired unit and 310 MW of wind generation (which is in the process of being supplemented by an additional 50 MW of wind investment).

For these reasons the Commission should find that the two companies in the ordinary course of their businesses acquire, operate, maintain and dispose of generation equipment such as turbines and that the Turbine Assignment was only one acquisition in a continual course of activity.

B. There is no dispute that the price paid for the turbines was at or even below prevailing market prices

It is clear that the price for turbines meeting MidAmerican's criteria was at or below prevailing market prices. Independent experts Suss and Greig verify that MidAmerican paid somewhat less for turbines via the assignment than it would have on the open market in 2001. [MEC Exhs. 3.0 and 4.0]. The independent experts have also testified Siemens-Westinghouse was the only vendor available to meet MidAmerican's capacity and timing needs. [MEC Exh. 3.0 at ll. 50-61; Exh. 4.0 at ll. 38-43; Tr. 88-89]. Staff concurs that the turbines were acquired at or below market prices. [Staff Exh. 1.0 at ll. 72-73; Staff Exh. 3.0 at ll. 160-164]. Clearly, MidAmerican acquired the turbines at a price that would have been at or less than the open market price. Indeed, given backlogs, quality issues and 18-24 month delivery periods, the evidence demonstrates that MidAmerican would not have been able to acquire a new turbine at all if it had not been able to take assignment of MidAmerican Holdings' ongoing commitment. [MEC Exh. 1.2 at p.1].

C. A determination of whether the turbine transaction was entered into in the ordinary course of business between MidAmerican and MidAmerican Holdings should not consider the frequency of transactions for generation equipment between the two affiliated interests

The Interim Order states at p. 8 "…nothing in the record suggests that it is 'in the ordinary course of business for MEC to turn to its affiliate for goods and services outside of an existing affiliate agreement." This statement suggests the focus of "ordinary course of business" as used in Section 7-101(3) should be on whether MidAmerican and MidAmerican Holdings normally enter into transactions with one another for generation equipment. MidAmerican would suggest that this is not the appropriate inquiry into the "ordinary course of business" under Section 7-101(3) and 83 Ill. Admin. Code §310.60(b). An interpretation of "ordinary course of business" that requires a showing that affiliated transactions are frequent or normal seems inconsistent with the intent of Section 7-101(3). The only reasonable construction of the "ordinary course of business" should focus on whether turbines are a product customarily used by MidAmerican and CalEnergy in their respective businesses, not whether the two companies customarily transact business with one another. If infrequent affiliated interest transactions are entered into by two related parties with a normal business need for a certain product, payment of a definable standard or prevailing market price will verify that a transaction approximates an arms' length arrangement and is reasonable.

II. Alternatively, MidAmerican has demonstrated that the Turbine Assignment was in the public interest pursuant to Section 7-101(3) of the Act

The Interim Order suggests the showing required in order for MidAmerican to secure Commission consent to the Turbine Assignment, if not exempted. The Commission found that MidAmerican had not demonstrated that a competitive turbine

solicitation conducted in 2001 would have resulted in (1) selection of Siemens-Westinghouse brand units; and (2) a market price comparable to the price paid by MidAmerican that took into consideration all possible turbine makes available for delivery in 2001. *Interim Order* at pp. 7-8. The testimony of independent turbine experts Suss and Greig in this proceeding demonstrates that the Turbine Assignment was a reasonable investment. According to the experts, if MidAmerican had purchased turbines at any time during 2001, in order to get a trouble-free model with a high likelihood of scheduled 2002 delivery, it would have paid between $35 and $40 million per turbine and only a Siemens-Westinghouse model would have been available to meet its needs. [MEC Exhs. 3.0 and 4.0]. MidAmerican's price under the Turbine Assignment of approximately $72 million net of taxes and technical assistance is at the low end of this range. [MEC Exh. 2.0 at ll. 45-51]. Clearly, MidAmerican paid no more than a market price for the turbines and the affiliated interest transaction should be approved in the public interest.

A. Siemens-Westinghouse turbines were the only makes that could meet MidAmerican's needs

In its Interim Order at page 8, the Commission suggested closer scrutiny of whether Siemens-Westinghouse turbines would have been selected had MidAmerican undertaken a separate competitive solicitation in the summer of 2001. MidAmerican has provided the necessary evidence to justify this conclusion in the form of additional testimony from independent power supply experts Irving Suss and Jeffrey Greig. [MEC Exhs. 3.0 and 4.0]. Both independent experts confirm the MidAmerican Holdings 1999 solicitation represented a complete review of potential turbine vendors that would have had suitable units available to MidAmerican in 2001. [MEC Exhs. 3.0 at ll. 50-61 and

4.0 at ll. 38-43; Tr. 89]. Both also confirm that the Siemens-Westinghouse machines would have been the only available option to meet MidAmerican's needs, even if a separate solicitation had been conducted in 2001. [MEC Exhs. 3.0 at ll. 54-61; 4.0 at ll. 38-43; Tr. 88-89]. At the hearing, Mr. Suss affirmed that there are really only three types of large, utility-size 60 cycle turbines suitable for use in a combined cycle combustion turbine – GE, ABB and Siemens-Westinghouse. [Tr. 88-89]. Both experts testified that in 2001, the same issues with GE units (backlog) and ABB units (turnkey installation, quality problems) continued as had caused MidAmerican Holdings to steer clear of them in 1999. [MEC Exh. 3.0 at ll. 50-64; 4.0 at ll. 26-43; Tr. 87-88].

B. MidAmerican's experts considered all models, and not just the Siemens-Westinghouse model ultimately selected by MidAmerican

The Interim Order suggested an infirmity in the verified affidavits furnished with MidAmerican's Application for Declaratory Order. The Interim Order noted at page 8 that "…MEC only asked the experts to determine the cost of a Siemens Westinghouse 501F gas turbine generator" and "…the extent to which [the experts] considered the price of other units is unclear." The Commission indicated it "…might be more inclined to agree with MEC's position if there was no question about the degree to which the experts reviewed the price of gas turbines from other sources." [*Id.*]

In their direct testimony filed in the affiliated interest proceeding, both experts Suss and Greig indicated that **all** models had been considered in their original assessments of market price. [MEC Exh. 3.0 at ll.50-61; Exh. 4.0 ll. 38-43]. Mr. Greig indicated that his original price analysis was only for the Siemens Westinghouse unit, but that the files he had reviewed in his independent assessment included as well a similar combustion turbine unit manufactured by General Electric, the GE 7FA. [MEC Exh. 3.0

at ll. 50-61; MEC Exh. 3.1 at p. 2]. Mr. Suss indicated that even though Mr. Crist had originally asked him the **value** of only the Siemens-Westinghouse model, in order to develop a sense of that value, he had to look at comparable machines, namely the GE and ABB models. [Tr. 88-89].

The sworn testimony of these experts demonstrates that their analyses broadly examined all applicable turbine makes and models. This fulfills the Commission's concern expressed in the Interim Order. The only remaining inquiry is whether the price for the Siemens-Westinghouse unit was within the range of the market price that MidAmerican would have paid absent the Turbine Assignment for delivery in 2001.

C. MidAmerican paid a price which was at most at the low end of the market for the turbines

There is no dispute by the parties to this proceeding that MidAmerican paid market price or below for the combustion turbines. Both experts independently confirm this conclusion. Mr. Suss, a secondary market broker, determined that the range would be from $35 to 40 million, depending on the accessories and services selected. [Tr. 84]. Independent power supply expert Greig confirmed a smaller but similar range of $38- 39 million, within a range of $1.5 million based on scope and commercial factors. [MEC Exh. 3.0 at ll. 37-43]. These prices demonstrate the Turbine Assignment was a beneficial investment for MidAmerican and its customers. MidAmerican was able to procure a turbine in an extremely tight market and, just as importantly, in a timely manner to meet customer and system reliability needs. MidAmerican paid at or slightly below a market price for the turbines. Both reasons demonstrate that the affiliated interest transaction is in the public interest and should be approved.

D. MidAmerican would have paid the same price for a turbine for delivery at <u>any</u> time in 2001, not just for one delivered during the summer of 2001

Mr. Crist has testified that the 2001 Load and Capability Study caused MidAmerican to determine capacity was required by the summer of 2003. [MEC Exh. 1.0 at ll. 98-122; MEC Exh. 5.1]. However, review of MidAmerican's "hot weather" forecast for 2003 actually shows a very slim margin of 6 MW above required minimum reserves. [MEC Exh. 5.1], which does not take into consideration the various contingencies outlined by Mr. Crist. Mr. Rockrohr suggests the 2001 Load and Capability study demonstrates that MidAmerican could have got along without GDMEC in 2003[2]. [Staff Exh. 3.0 at ll. 115-142].

However, a delay in construction to 2004 would not have reduced the price of the turbine. As Mr. Suss testified, turbine demand was strong throughout the entire year 2001. [Tr. 88]. In order to procure a turbine for delivery in early 2004, MidAmerican would likely have had to commit to a turbine by the end of 2001. The strong demand through all of 2001 suggests that even if MidAmerican had delayed its investment until the end of the year and then gone to the open market, if it had been able to procure a turbine at all, it would have experienced the same pricing as in the Turbine Assignment. Accordingly, MidAmerican's turbine price should be considered reasonable regardless of whether the capacity would have been placed into service in 2003 or 2004 and whether purchased from an affiliated interest or on the open market.

III. The Commission should not adopt Mr. Rockrohr's suggestion to expand review of the Turbine Assignment affiliated interest transaction to encompass considerations of the price and need for GDMEC

[2] Mr. Rockrohr does not appear to dispute that capacity would have been needed by 2004 under the forecast.

Mr. Rockrohr concurs with the assessment of witnesses Crist, Suss and Greig that MidAmerican paid a price for the turbines that was at or below market. [Staff Exh. 1.0 at l. 72-73; Staff Exh. 3.0 at ll. 160-164]. However, his position is that the price paid for the turbines is not relevant to the Commission's inquiry into the public interest. Instead, he argues that the Turbine Assignment cannot be in the public interest if construction of GDMEC as a whole was not prudent. [Staff Exh. 1.0 at 88-92]. Mr. Rockrohr's position is that inquiry into GDMEC is appropriate because ultimately "…MEC will seek to include its costs associated with the GDMEC into Illinois rates once the current rate-freeze ends, including its costs for the two combustion turbines". [Staff Exh. 1.0 at ll. 91-94]. Ratemaking considerations have no place in an affiliated interest transaction proceeding. Mr. Rockrohr's argument should be rejected by the Commission.

A. Mr. Rockrohr's position is not only inconsistent with Mr. Knepler but also with express provisions of Section 7-101(3)

As Staff witness Knepler acknowledges, consent to an affiliated interest transaction pursuant to Section 7-101(3) of the Act does not bind the Commission in ratemaking. [Staff Exh. 2.00 at ll. 169-186]. The express language of Section 7-101 provides that an affiliated interest ruling is to have no binding effect on ratemaking:

> The consent to, or exemption or waiver of consent to, any contract or arrangement under this Section…does not constitute approval of payments thereunder for the purpose of computing expense of operation in any rate proceeding.

A decision of the Commission in this proceeding - whether it approves, exempts or disapproves the Turbine Assignment - will have absolutely no bearing on any subsequent ratemaking proceeding. Mr. Rockrohr's position that the value of the entire GDMEC unit should be considered, along with application of ratemaking standards of prudency,

should be rejected by the Commission. It is simply inconsistent with the express language of the Act.

B. Section 9-211 of the Act does not mandate one standard for analysis of prudent rate base investments

Section 9-211 of the Act is cited by Mr. Rockrohr as support for his position that MidAmerican should have conducted an RFP prior to deciding upon GDMEC. [Staff Exh. 1.0 at ll. 89-101]. Mr. Rockrohr's reliance on that section to support his position that an RFP was to be conducted by MidAmerican is misplaced. Section 9-211 simply requires an investment to be "prudent" and "used and useful" in providing service to customers to be reflected in rate base. There is no requirement in this section for competitive bidding prior to rate base inclusion and there is no suggestion in the section or applicable case law that only one method of analysis may be undertaken in order to confirm that a utility investment is prudent. On the contrary, *Illinois Power II*, 339 Ill. App. 3d at 435; 790 N.E. 2d at 384-385 suggests that different analytical methods can be used to lead to a conclusion that a utility investment is reasonable, or, in other words, that reasonable minds can differ in how a prudency determination is conducted.

C. Unlike in Section 7-101, the legislature has not prescribed methods for analysis of prudent investments for ratemaking purposes

Contrasting the requirements of Section 9-211 of the Act with those of Section 7-101 is also illustrative of the flaws in Mr. Rockrohr's suggestion that an RFP requirement be read into Section 9-211. In addressing affiliated interest transactions, at Section 7-101(4) of the Act, the General Assembly has specifically set forth detailed methods that can be used by the Commission to consider whether to waive consent to

affiliated interest transaction. One of the manners specified is when a utility takes the most favorable bid "as ascertained by competitive bidding." There is no similar method prescribed in Section 9-211 for determination of prudent investments.

If the General Assembly intended for a competitive process to be the only way in which a utility could demonstrate that a generation investment warranted inclusion in rate base, it would have added comparable instructions to Section 9-211. Mr. Rockrohr is simply adding requirements into Section 9-211 where none exist and where legal precedent suggests a reasonable perspective should be employed.

D. Mr. Rockrohr's improperly assumes that MidAmerican will include all costs of GDMEC in rates

The premise of Mr. Rockrohr's argument that the cost of GDMEC should be investigated in this proceeding is that the turbines form an indivisible part of the unit, and the indivisible costs will be evaluated for inclusion in rates under Section 9-211 of the Act at the end of the mandatory transition period. [Staff Exh. 3.0 at ll. 85-101].

Inclusion of GDMEC in rates is not MidAmerican's only option. The public utility, not the regulatory agency, determines which property is dedicated to public service. MidAmerican can choose not to dedicate GDMEC and other generation to public service in Illinois. Adoption by the Commission of Staff's rigid position, with its significant consequences for MidAmerican's substantial investment in new generation could lead MidAmerican to the conclusion that it should not dedicate its new generation investments to public service in Illinois.

IV. An RFP is only one way to determine a generator is a prudent investment

Staff witness Rockrohr takes the position that the Turbine Assignment should be disapproved by the Commission, contending that in order to secure approval, MidAmerican should demonstrate that GDMEC **as a whole** was a prudent investment by providing "…evidence that constructing the GDMEC prior to the summer of 2003[3] was the least-cost alternative to obtain that capacity." [Staff Exh. 1.0 at ll.78-80]. He appears to consider only an RFP, which he describes as a process that allowed MidAmerican to consider "…genuine alternatives with genuine associated costs…" suitable to provide the showing he demands. [Staff Exh. 3.0 at ll.191-193]. He concludes that MidAmerican should not be permitted to "..impose or seek to impose, any additional costs on its Illinois ratepayers that arose from its affiliate agreement and its choice to build capacity, apparently driven by new Iowa legislation." [Staff Exh. 3.0 at ll. 40-43].

There was no prior precedent at the time MidAmerican entered into the Turbine Assignment that supports Staff's position that an RFP was a prerequisite. If the Commission should consider Mr. Rockrohr's approach to have merit, MidAmerican believes the evidence provided in the record demonstrates GDMEC (and not just the associated turbines) was a reasonable option to meet its generation needs.

A. GDMEC was a reasonable option for summer 2003 generation needs

Company Exhibit 5.2 consists of an extensive analysis performed by Dr. Joseph S. Graves of MidAmerican's generation requirements demonstrating that of the need for GDMEC. Dr. Graves compared GDMEC to four options – a single cycle combustion turbine, a coal-fired unit, wind generation, supplemented by a power

[3] Mr. Rockrohr consistently refers to MidAmerican's construction of GDMEC as occurring "prior to the summer of 2003," as he does in this quotation. This characterization suggests that MidAmerican placed the unit into service before it was needed to meet the forecast capacity needs of its customers for capacity in the summer of 2003. GDMEC was placed into service in 2003 to meet these needs. The turbine was installed one year earlier; but the unit was not operational at that time.

purchase and a long-term power purchase. [MEC Exh. 5.0 at ll. 386-390; MEC Exh. 5.2]. The comparison demonstrated that GDMEC was by far MidAmerican's best option for generating supply. On five of the seven criteria, GDMEC ranked most favorably. The analysis involved use of standard generation planning techniques of a production cost modeling simulation that assumed in each instance that MidAmerican owned the generation plant, operated it for 25 years and dispatched it on its system during that period. [MEC Exh. 5.2].

Mr. Rockrohr's reliance on an RFP as the only way to determine that a generating unit is least cost is misplaced. First, there is no legal authority for his position that an RFP should be conducted in order to reflect generator investment in rates. Second, as Mr. Crist has testified, an RFP in this circumstance may not have provided the same level of comfort. Once H.F. 577 was passed, it was clear that utilities in Iowa had a significant incentive to construct generation instead of entering into power contracts. It was a real possibility that RFP responses would not be realistic.[4] [MEC Exh. at ll. 507-516]. Third, the options that Mr. Rockrohr suggests MidAmerican should have considered (construction of an Iowa generator by a third party; a new or extended power purchase from a close-by or remote unit [Staff Exh. 3.0 at ll. 143-153] were not realistic as they would not have permitted MidAmerican to meet the overall needs of Iowa in the same manner as Iowa generation. Finally, and most importantly, Dr. Graves' analysis showed that GDMEC was MidAmerican's best option. This study shows that GDMEC was the best choice for MidAmerican and for the State of Iowa.

[4] This may suggest that the Interstate RFP suffered the same shortcomings.

B. The cost of GDMEC is comparable to other Iowa-based generation constructed at about the same time period

Assuming the RFP conducted by Interstate provides credible evidence of the price of a combined-cycle combustion turbine generator, the comparable cost resulting from that solicitation demonstrates GDMEC was a prudent investment. GDMEC and the Interstate gas plant are similar in design, cost and other characteristics. [MEC Exh. 5.0 at ll. 536-537]. The capital cost of Interstate's plant is approximately $706 per kW, as compared to GDMEC's cost of $722/kW, a difference of only 2.3%. [MEC Exh. 5.0 at ll. 537-541]. Mr. Rockrohr arbitrarily suggests it is only appropriate to compare plant costs by removing from the Interstate gas plant costs certain "site-specific" costs. [Staff Exh. 3.0 at ll. 244-262]. This removal increases the comparative plant cost differential to about 10%. [Staff Exh. 3.0 at ll. 254-255].

Eliminating categories of costs makes a comparison invalid and starts the process of taking the analysis down a slippery slope. A reasonable analysis of comparative costs should not selectively exclude cost items. The units are very comparable in price. Mr. Rockrohr's suggestion the costs are otherwise should be rejected.

V. The Commission's rules do not support disallowance of AFUDC for the turbine

Staff witness Knepler takes the position that AFUDC should not be recovered because the Commission's accounting rules require a permit to be issued prior to accrual. [Staff Exh. 2.00 at ll. 131-148]. Mr. Knepler bases his position on a FERC accounting release referencing specific federal permit requirements. [Staff Exh. 2.00 at ll. 134-144]. Specifically, Federal Energy Regulatory Commission Release AR-5 provides that the starting point for capitalizing AFUDC is the date of issuance of either a preliminary

hydroelectric project permit or a certificate for natural gas facilities. Mr. Knepler testifies that the very specific language of this release is a "general statement" of the starting date for the collection of AFUDC. [ICC Staff Exh. 4.00 at ll. 35-37]. Staff's position suggests that the Commission's accounting requirements are to be liberally interpreted. Liberal interpretation of AR-5 raises questions. If the Turbine Assignment is ruled to be in the ordinary course of business, thus not requiring a permit from the Commission – may AFUDC be collected? If so, what would be the starting point for that AFUDC? When these questions are asked, Staff's position that the affiliated interest transaction approval is the AR-5 permit required for accrual of AFUDC becomes difficult to follow. An interpretation that is consistent with the types of permits sought in the rule – construction permits – while still inconsistent with the explicit language of AR-5, is more consistent with Staff's view of AR-5 as a "general statement."

Because GDMEC is located in Iowa, not Illinois, MidAmerican was not required to obtain the same type of construction permit from the State of Illinois as is referenced in FERC Accounting Release AR-5. Indeed, if not required to obtain affiliated interest approval, MidAmerican would have had no legal requirement for Commission authorization for GDMEC. MidAmerican did, however, obtain appropriate construction permits from Iowa authorities. If AR-5 is ruled to apply to MidAmerican's accrual of AFUDC in this proceeding, the date of Iowa construction permits should be used under AR-5 as the date for accrual of AFUDC. Otherwise, Staff's proposed interpretation of AR-5 cannot be applied in a consistent manner to all utility construction whether located inside or outside of the State of Illinois but potentially affecting Illinois utility customers.

CONCLUSION

The Commission should waive consent to the assignment of the Turbine Contract. The evidence in the record of this affiliated interest proceeding demonstrates that the Turbine Assignment was entered into in the ordinary course of business at or below standard or prevailing market prices and thus does not require Commission consent. Alternatively, the evidence demonstrates that the Turbine Assignment is in the public interest and the Commission should give the affiliated interest transaction its consent. MidAmerican's analyses of price and need for the turbines and price and need for GDMEC support these decisions. There is no requirement from prior precedent, either in the form of cases issued in ratemaking proceedings or affiliated interest transactions, that the Commission may only rely on one analytical method for determining whether generation plant is prudent. MidAmerican's analysis demonstrated conclusively that GDMEC was the best option for MidAmerican and the associated Turbine Assignment must be approved in the public interest.

DATED this 2nd day of September, 2005

MIDAMERICAN ENERGY COMPANY

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