STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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

REPLY BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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The Staff of the Illinois Commerce Commission ("Staff") hereby submits its Reply Brief in this matter.

1. INTRODUCTION

Staff in its initial brief set forth the three-step analysis which Staff witness Rockrohr undertook when reaching the conclusion that MidAmerican Energy Company's ("MEC") agreement with its affiliate was not in the public interest. MEC on the other hand argues again that its affiliate interest agreement with its affiliate, MidAmerican Energy Holdings Company ("MEHC"), is exempt from Commission approval under Section 7-101(4) of the Public Utilities Act ("PUA") and 83 Ill. Admin. Code Section 310.60(b). MEC refuses to acknowledge that the Illinois Commerce Commission ("Commission") has already found that the agreement is not exempt from Commission approval and must be found to meet the public interest standard of Section 7-101(3). Staff will briefly address that issue but will focus on the flawed arguments made by MEC that its agreement is in the public interest. While Staff agrees that the Commission has broad discretion in deciding whether an affiliate agreement is in the public interest, Staff disagrees with MEC's argument that the Commission should "simply review the price paid." Such a review would be nothing more than a rubber stamp. MEC ignores the stated intent under the PUA that utility service is to be provided at least cost (220 ILCS 5/1-102 and implicit in Section 7-101) and makes many flawed arguments, including that Staff is somehow conducting an illegal hindsight/after the fact prudence review and that, if the Commission adopts Staff's analysis, it will be violating the Commerce Clause. Staff's brief addressing those arguments and others follows.

II. ARGUMENT

A. The contract between MEC and its affiliate does not meet the waiver requirements of 220 ILCS 5/7-101(4) and 83 Ill. Adm. Code 310.60

Despite the fact that the Commission denied MEC's declaratory ruling request that its affiliate transaction met the waiver requirements, MEC argues in its initial brief that its transaction does meet the waiver requirements of 310.60(b) (MEC IB, p. 4). The Commission's Interim Order was very clear in not one but three places – the Conclusion, Finding 4 and the first Ordering paragraph - that MEC's declaratory ruling request was denied. (Interim Order at 4-5). Rather than face that fact, MEC twists the Commission's words and argues that this is still an open issue. MEC argues that its transaction with MEHC was made in the ordinary course of business. However, the evidence in the record does not support MEC's claim. First, Staff witness Rockrohr testified that prior to the acquisition of the turbines from its affiliate, MEC had not acquired a combustion turbine since 1993. More importantly Staff witness Rockrohr testified that he found no instance where MEC on any prior occasion had <u>ever</u> acquired combustion turbines from an affiliate. (Staff Ex. 1.0, p. 6). MEC describes the business interests of CalEnergy, MEC's unregulated affiliate, as if CalEnergy's business and construction activities should somehow be assigned or attributed to MEC. (MEC IB, pp. 14-15). However, the business interests and activities of another one of MEC's affiliates are not relevant to the Commission's approval of MEC's affiliate interest agreement with MEHC. The evidence indicates that MEC did not solicit bids for combustion turbines from any other potential suppliers other than its affiliate. If acquiring turbines from an affiliate was in the ordinary course of business for MEC then there would be a history of such transactions. MEC offered no evidence in the record of a single other instance where such a transaction occurred. Instead, the evidence in the record is that the only instance of such a transaction is the one which is the subject of this proceeding.

The Commission in its Interim Order was particularly concerned that the turbines were not acquired in the ordinary course of business. The Commission noted that "nothing in the record suggested 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" and for that reason was reluctant to find "such a significant purchase from an affiliate" to be in the ordinary course of business. (Interim Order at 8). Because MEC's ordinary course of business argument completely ignores the fact that Mr. Rockrohr found no instances where MEC on any prior occasion had acquired combustion turbines from an affiliate[1] and the previously expressed concern of the Commission, MEC's argument should be rejected and MEC's request for a declaratory ruling should be denied again by the Commission.

B. The Commission should not approve MEC's affiliate agreement under Section 7-101(3).

1. The Commission is not a rubber stamp.

MEC would like the Commission to be nothing more than a rubber stamp by limiting its analysis of MEC's affiliate transaction to a simple review of the reasonableness of the price paid by MEC for the turbines. (MEC IB, p. 10). The

[1] The fact that Mr. Rockrohr found no instances where MEC on any prior occasion had acquired combustion turbines from an affiliate is also relevant when considering the flawed argument that MEC makes regarding the recent ruling in an Illinois Power purchased gas adjustment ("PGA") matter ("Illinois Power II") (MEC IB, p. 11). That argument will be discussed later in this brief.

Commission should reject MEC's argument that the Commission has only to review the reasonableness of the price paid to fulfill its statutory obligation. A three-step analysis as recommended by Staff is warranted in this docket. Those three steps are that (1) the Commission must determine whether MEC demonstrated it needed the additional capacity prior to the Summer of 2003 for which the turbines were being acquired, (2) the Commission must determine whether MEC demonstrated that its construction of the Greater Des Moines Energy Center ("GDMEC") for which the turbines were being acquired was MEC's least cost option to acquire the additional capacity and that (3) the Commission must determine that MEC demonstrated that the price it paid for the turbines did not unfairly benefit its affiliate. (Staff IB, p. 3). Staff's initial brief set forth how MEC failed to meet steps one and two. While MEC did meet step three, whether MEC paid a fair market rate for the turbines is not determinative if there was no need for additional capacity or if there were less costly alternatives that did not require the acquisition of the combustion turbines. (Staff IB, p. 8).

Even if the Commission were to only look at the price paid by MEC for the turbines, the standard would not be that the price paid was reasonable as MEC suggests, but rather that the price paid was at or below market prices. (Staff IB, p. 8). Any lesser standard would be contrary to Section 7-101. Section 7-101(4) exempts certain transactions only if they are made at or below the market price. (220 ILCS 5/7-101(4). If transactions exempt from Commission approval have to be made at or below market with the exception of "prices or rates fixed pursuant to law", certainly those transactions which are not exempt, like MEC's affiliate agreement here, must meet the same price standard.

2. The facts in the Illinois Power II case are much different than the facts in this proceeding.

MEC argues that Staff is “attempting, using hindsight, to hold [MEC] to an ‘after the fact’ standard of review” (MEC IB, p. 11) by appearing to rely upon a Commission decision in Interstate Power and Light Company (“IPL”) which was issued almost two years after MEC’s decision to acquire the turbines. (Id.). MEC argues that “after the fact” standard of review is similar to the position Staff took in an Illinois Power PGA docket in which the Appellate Court reversed the Commission’s order and found the Commission’s decision to be arbitrary and the creation ‘after the fact’ of a standard of care that was applied by the Commission using hindsight. (Id. at 12). MEC refers to that matter as ‘Illinois Power II’. MEC fails to recognize that, given the fact that it entered into a transaction with its affiliate without first seeking Commission approval, then any standard which the Commission applies to MEC’s affiliate transaction is going to be done ‘after the fact.’ Therefore, it is disingenuous for MEC to make such an argument. MEC should have sought Commission approval before entering into an agreement with MEHC. IPL, who MEC refers to in its initial brief, followed such a procedure but MEC failed to act in a similarly appropriate manner.

MEC’s reliance on “Illinois Power II” is misplaced. In Illinois Power II the court found that the Commission had an established practice from which it departed when it came to IP’s 2000 PGA docket. The facts in Illinois Power II were as follows. IP owned five propane plants and with respect to the retirement of the first four propane plants, the Commission never told IP that it had to conduct a present value revenue requirement analysis (“PVRR”). In IP’s 2000 PGA docket, Staff contended that such an analysis was necessary to determine whether the retirement of the propane plant was prudent. The court concluded that in 2000 when IP was deciding whether to retire the propane plant it would have been reasonable for IP, based upon its past experience, to have concluded that a PVRR analysis was not necessary to demonstrate that the retirement of the propane plant was prudent. (Illinois Power Company v. Illinois Commerce Commission, 339 Ill.App. 425 (LEXSEE 339 ILL. APP. 3D 425, p. 7)). The court found that the Commission created a new standard departing from past practice (Id. at 7) and based upon a review of the record no facts were provided as to why a PVRR was necessary.

The facts in Illinois Power II are far different than the facts in this proceeding. In this proceeding. There is no analogous history of Commission activity like there was in Illinois Power II. There were not four prior turbine transfers between MEC and an affiliate. MEC had never before entered into a similar transaction with an affiliate. Therefore, there can be no prior practice from which the Commission would be departing from when analyzing whether MEC's affiliate interest agreement was in the public interest. Also, in this proceeding Staff has provided expert testimony as to why each step in its three step analysis is necessary to determine whether a transaction is in the public interest. The prudent action for MEC to have taken would have been to obtain from the Commission approval of its affiliate interest transaction before taking possession of the turbines and constructing GDMEC. The failure to ask the Commission for advance approval should not shield MEC from the Commission applying the appropriate analysis to MEC's affiliate interest agreement.

3. The Commerce Clause does not require the Commission to approve MEC's affiliate interest contract.

MEC argues that Staff's position if adopted by the Commission would violate the Commerce Clause. (MEC IB, pp. 12-13). MEC's argument should be rejected for a number of reasons. First, MEC argues that Staff insisted on an RFP as being the sole way to demonstrate that the affiliate contract was in the public interest. (MEC IB, p. 13). As will be discussed in further detail in this reply brief, a review of Mr. Rockrohr's testimony shows that Mr. Rockrohr never testified that an RFP was the only way for MEC to demonstrate that constructing MEC's GDMEC prior to the summer of 2003 was the least cost alternative (220 ILCS 5/1-102) to obtain additional capacity. While it is true that Mr. Rockrohr had concerns that that MEC's cancellation of an existing RFP resulted in a lost opportunity for MEC and regulators to compare the costs associated with building the GDMEC to the costs associated with other alternatives (Staff Ex. 1.0, p. 8), he never testified that an RFP was the sole way for MEC to demonstrate that a lower cost alternative to the GDMEC did not exist and he certainly never testified that if the GDMEC was in fact least cost that the Commission should not consider it in a least cost analysis due to the fact that the GDMEC is located in Iowa.

Second, MEC's analysis of the Commerce Clause is not persuasive. It relies solely upon a very limited analysis of a single case United Air Lines, Inc. v. Illinois Commerce Commission, 32 Ill.2d 516. (MEC IB, p 13). MEC's reliance on the United case is misplaced given that the facts in that case are significantly different than the facts in this case. In United, only a small fraction of United's entire business was transacted in Illinois whereas most of United's facilities were used for interstate traffic. Given that only a small fraction of United's business was transacted in Illinois, the court found the local interests involved to be incidental and therefore the local interest was overcome by the burden that would have been imposed on interstate commerce. United at 525-527.

In this case, there is MEC in whose last delivery services docket, the Commission approved operating revenues equal to $35,302,000 and a delivery services rate base equal to $87,632,000 for MEC's service territory (ICC Docket No. 01-0444, Order at 22, finding 7) which includes the greater Illinois Quad Cities area. In addition, as the cited facts establish, and which MEC itself has previously admitted, "the Commission has ratemaking authority, combined with … broad authority regarding the relationship of electric utilities with their affiliated interests …." (Order in ICC Docket No. 00-0197, (2000 Ill. PUC LEXIS 534, page 3)). The court in United found that there was an undue burden on interstate commerce given the local interests of Illinois that were only incidentally involved, if involved at all. (United at 525-526). Clearly, MEC's transactions in Illinois are far more significant and have a greater impact on Illinois residents than the miniscule amount of revenue United earned from its intrastate transactions in Illinois (Id. at 518) in comparison to the impact Illinois regulation would have had on its overall national operations. (Id. at 519). Given the important factual difference between the United case and the facts at issue here, MEC's Commerce Clause argument should be rejected.

Third, MEC's Commerce Clause argument should also be rejected given that when applying the facts in this case to the established Commerce Clause test, i.e., the Pike balancing test (Pike v. Bruce Church, Inc., 397 U.S. 137(1970) (1970 U.S. LEXIS 63), there is no violation. When that test is applied, it is clear that Section 7-101 as applied by Staff would not violate the Commerce Clause. It has long been established that there are two aspects to the Commerce Clause. The first grants Congress the authority to regulated commerce among the states but also it has been established that it also directly limits the power of states to discriminate or burden interstate commerce. The second aspect which is in the negative is referred to as the Dormant Commerce Clause. It is invoked to invalidate overreaching provisions of state regulation of commerce. (Alliant Energy Corporation and Wisconsin Power and Light Company v. Ave M. Bie, et al 330 F3d. 904 (2003) (2003 U.S. App. LEXIS 10671, p. 4)). A party seeking to invalidate a state statute must show that there is some burden on interstate commerce. If no burden is shown then the Dormant Commerce Clause is not implicated and the statute will not be invalidated. (Id.). In the case where interstate commerce is burdened, the Supreme Court has adopted a two tiered approach to determine the validity of the statute. (Id.). The first tier is most often referred to as the "virtual per se" rule. The rule is applied when a statute "'directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests'" (citations omitted) (Id.). In those instances the Court generally strikes down the statute without further inquiry. (Id.).

The second tier is for those cases where a statute "'has only indirect or incidental effects on interstate commerce and regulates evenhandedly.'" (Id. at 4-5). If that is the case then "the statute will be upheld 'unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.'" (Id.). That test is known as the Pike balancing test. (Id.). When deciding which tier to apply, the rule of thumb is that "essentially any statute that facially discriminates against out-of-state commerce will fall subject to the per se rule [the first tier], and all other statutes that have an effect on interstate commerce will be analyzed under the Pike balancing test." Id.

A review of Mr. Rockrohr's analysis in applying Section 7-101 shows that he is not advocating Illinois economic interests over out-of-state economic interests. In particular, he is not favoring Illinois' economic interest over Iowa's economic interests[2] as MEC suggests. (MEC IB, pp. 12-13). Mr. Rockrohr simply testified that among other things, MEC provided no evidence that constructing the GDMEC was the least-cost alternative to obtain additional electric generating capacity. (Staff IB, p. 3). Mr. Rockrohr also testified that MEC failed to demonstrate that it needed the additional capacity in 2003. (Staff IB, pp. 3-4). Nowhere does Mr. Rockrohr testify that MEC had to construct a plant in Illinois or purchase additional power from an Illinois supplier in order to serve Illinois ratepayers at the least cost. Also, nowhere did Mr. Rockrohr testify that power produced from the GDMEC should not be considered in a least cost analysis because it was generated from a location inside of Iowa rather than Illinois. Since the first tier of the test clearly does not apply Staff will move on to the second tier analysis, the Pike test.

As previously mentioned the Pike test is as follows: "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effect on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to putative local benefits. Huron Cement Co. v. Detroit, 362 U.S. 440, 443. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of

[2] MEC simply ignores the fact that on its face the Iowa law appears to favor Iowa's interests over those of other states. However, Staff will not analyze the Iowa law under the first tier given that such an analysis is not necessary to show that Mr. Rockrohr's analysis does not violate the Commerce Clause.

course depend on the nature of the local interest involved, and on whether it could be promoted as well with a less impact on interstate activities." (Pike v. Bruce Church, Inc., 397 U.S. 137(1970) (1970 U.S. LEXIS 63, page 3)). The purpose of Section 7-101 is to "insulate public utilities from financial exploitation" (Estate of Besinger v. Carpentersville, 258 Ill. App. 3d 218, 225 (1994)). Mr. Rockrohr was rightfully concerned that MEC entered into the contract with its affiliate to relieve MEHC from an obligation to purchase turbines that MEHC no longer needed to the detriment of MEC and provide MEC's parent, i.e., its ultimate shareholder, with a more favorable return to the detriment of the utility. (Staff Ex. 3.0, p. 2). Sufficient motivation could have existed for MEC's affiliate to unload the turbines on MEC even if the price paid was a market price at the time. It was for these reasons that Mr. Rockrohr undertook the first two steps in his analysis (Step One - was there a need for the GDMEC? and Step Two - was the GDMEC least cost?). These two steps must also be considered by the Commission when deciding whether it would be in the public interest to approve MEC's affiliate interest agreement with MEHC. To the extent, if any, that Mr. Rockrohr's analysis somehow has an effect on interstate commerce[3], which Staff does not concede, the legitimate public interest of preventing the financial exploitation of MEC by its parent, MEHC, is most certainly not over come by the alleged burden on interstate commerce.

4. MEC is wrong that a Commission decision in this proceeding has no bearing on any subsequent ratemaking proceeding.

MEC argues that a "decision of the Commission in this proceeding - whether it approves, exempts, or disapproves the Turbine Assignment – will have absolutely no

[3] MEC cites to no evidence in the record of any burden being imposed on interstate commerce, rather it simply makes an unsupported allegation. (MEC IB, pp. 12-13).

bearing on any subsequent ratemaking proceeding." (MEC IB, p. 22). However, a denial of MEC's affiliate agreement would have an effect on a future ratemaking proceeding. Section 7-101(3) states that "Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void." The law in Illinois is that, if the Commission were to deny approval of MEC's affiliate agreement with MEHC, which it should, the costs from that agreement could not be included in rates. (Metro Utility v. Illinois Commerce Commission, 262 Ill. App.3d 266, 274 (1994)). MEC is also wrong that Mr. Rockrohr's position is inconsistent with 7-101(3) and Mr. Knepler's testimony. Even if MEC paid a market price for the turbines, if MEC did not need the additional capacity of GDMEC and GDMEC was not least cost, the affiliate agreement between MEC and MEHC could not be in the public interest. The fact that Section 7-101(3) states that "[t]he 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." (220 ILCS 5/7-101(3)) Section 7-101(3) does not restrict in any way the type of analysis that is necessary to determine whether the agreement between MEC and its affiliate was in the public interest.

5. Staff witness Rockrohr's analysis is not based upon the position that MEC had to conduct an RFP.

MEC has apparently adopted the tactic of repeatedly stating something which is not true in the hope that the Commission will accept it as true. MEC argues over and over again that Staff witness Rockrohr testified that MEC had to conduct an RFP in order to prove that its affiliate interest contract is in the public interest[4]. (See MEC IB, pp. 11, 12, 13, 23, 25, 26 and 29). Staff's position which is supported by Mr. Rockrohr's testimony is that an RFP would be the best way for MEC to demonstrate its proposed capacity additions would be the least cost to meet customers needs. However, if an RFP was not conducted, then MEC needed to demonstrate through some other method that construction of the GDMEC prior to the Summer of 2003 was least cost. Of course, to demonstrate least cost, "MEC would need to consider genuine alternatives with genuine associated costs, not hypothetical alternative costs that it contrived." (ICC Staff Ex. 3.0, p. 10). If a lower cost alternative was available, MEC would have no need for the turbines, and the affiliate interest agreement would not be in the public interest.

6. The Commission's jurisdiction under Section 7-101 is not limited to reviewing solely those affiliate agreements where the costs associated with the agreement are recovered in rates.

MEC in its initial brief appears to take the position that if MEC chose to not dedicate the GDMEC to Illinois rate payers the Commission would not have the authority to review its affiliate interest agreement for the combustion turbine transfer. (MEC IB, p. 24). MEC cites to no authority and Staff is aware of no precedent which would support that Commission approval under Section 7-101 is necessary only when the utility plans to attempt to recover the cost of the affiliated agreement from ratepayers. The language in Section 7-101 is clear that "No … contract … made with

[4] MEC also makes the claim that Mr. Rockrohr took the position that the price paid for the turbines was not relevant. No where in Mr. Rockrohr's testimony does he make such a statement. In fact the third step of Mr. Rockrohr's analysis was whether "the price paid for the turbines to its affiliate did not unfairly benefit its affiliate …" (Staff IB, p. 7).

any affiliate interest … 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 Section 16-111 of the Act" (220 ILCS 5/7-101(3). MEC's apparent interpretation of Section 7-101 is not consistent with that language. At no place in Section 7-101 does it state that Commission consent is only necessary where the contract costs would be recovered from ratepayers. MEC's argument should be disregarded.

7. MEC has failed to meet its burden of proof.

MEC in its brief argues that GDMEC was a reasonable option to meet its capacity needs for the Summer of 2003 and that its <u>cost</u> was comparable to other Iowa-based generation constructed at about the same period. (MEC IB, pp. 25-27). The Commission should reject both of those arguments. As Staff pointed out in its initial brief, using MEC's planning approach, Table I in MEC's exhibit No. 5.1 appears to indicate that MEC would have adequate capacity to meet customer load and MAPP reserve requirements (without the GDMEC's capacity) until MEC's purchase agreement with Cordova Energy Company ("Cordova") expired, in May of 2004. (Staff IB, pp. 3-4). In addition, MEC's own witness in its Iowa proceeding stated "'MidAmerican has identified a need for additional source of electric supply to meet its customer needs in the 2004-2005 time frame.' (MEC Ex. 5.2, Direct Testimony of Joesph S. Graves submitted before the Iowa State Utilities Board in Docket No. RPU-01-9, page 4, lines 14-18) (ICC Staff Ex. 3.0, pp. 6-8)" (Staff IB, pp. 3-4).

Despite MEC's claims that it needed to place GDMEC on line prior to the Summer of 2003 to assure that adequate and reliable power was available for its customers in a wide variety of conditions (MEC Exhibit 5.0, p. 6), the "wide variety of conditions" to which MEC refers includes conditions outside MEC's stated planning approach. The data and generation planning information MEC submitted indicated MEC would not need additional capacity until MEC's purchase agreement with Cordova expired in May of 2004. (Staff Exhibit 3.0, pp. 6-7). Therefore, "MEC had time to compare the costs of proposals associated with other alternatives to its cost for constructing the GDMEC, even though it chose not to do so." (Staff Exhibit 3.0, p. 7).

MEC is attempting to convince the Commission that the GDMEC provided capacity at lower cost than other available alternatives by utilizing the analysis and testimony of Joseph S. Graves, which it had previously presented to the Iowa Utilities Board ("IUB") in IUB Docket No. RPU-01-9. (MEC Exhibit 5.2). However, Mr. Rockrohr testified that the analysis described in Dr. Grave's testimony was inadequate to identify the least-cost alternative. (ICC Staff Ex. 3.0, pp. 9-10). Also, Dr. Graves testified in IUB Docket No. RPU-01-9 that the analysis he conducted was <u>not</u> an attempt to identify MEC's least cost alternative to obtain additional capacity (MEC Exhibit 5.2, Attachment to Data Request ENG 2.6, page 6, beginning at line 16). Despite Dr. Graves' explanations, MEC in Dean Crist's rebuttal testimony describes Dr. Graves' analysis as "…the least cost analysis that was prepared by MidAmerican in conjunction with its decision to construct GDMEC." (MEC Exhibit 5.0, p. 19).

In response to MEC's argument that the cost of GDMEC is comparable to other Iowa-based generation, Mr. Rockrohr, who was also the Staff witness in the IPL matter pointed out that while the IPL plant and the GDMEC had similarities, there were also differences between the two plants. (ICC Staff Ex. 3.0, p. 11). In addition to differences in some primary plant components, Mr. Rockrohr testified that IPL stated that it chose a specific site for its generating plant due to the proximity of two competing gas pipelines, and that utilizing that specific site added $30.8 million to IPL's project cost. (ICC Staff Ex. 3.0, p. 12). MEC told Staff that there were no comparable site-specific costs associated with construction of the GDMEC (ICC Staff Ex. 3.0, p. 12). Therefore, Mr. Rockrohr reasonably concluded that to compare costs associated with constructing GDMEC to costs associated with constructing IPL's project the additional $30.8 million site-specific costs that IPL incurred needed to be excluded. (ICC Staff Ex. 3.0, pp. 12-13). IPL's project cost, excluding the $30.8 million in site-specific costs, was $651 per kilowatt of added generating capacity. MEC's cost for the GDMEC was $722 per kilowatt of added generating capacity. MEC's cost for its GDMEC is more than ten percent higher than the $651 per kilowatt cost for IPL's project with site-specific costs excluded. (ICC Staff Ex. 3.0, pp. 12-13). Despite MEC's objection, it was reasonable for Mr. Rockrohr to exclude the additional $30.8 million in site-specific costs from the IPL total project cost when making a comparison to GDMEC given the fact that MEC had no comparable site specific costs.

Finally, MEC argues that HF577 closed the door on power plant construction for the purpose of utility sale or supply, alleging that its RFP would not have yielded realistic results (MEC IB, p. 26). However, IPL was able to execute a meaningful solicitation after HF577 was enacted. IPL's solicitation resulted in 15 bidders and 46 proposals. Some of the proposals IPL received in response to its solicitation indicated very comparable costs to IPL's utility-build alternative with site-specific costs excluded. (MEC Ex. 5.4, pp. 9 and 18-19 and MEC Ex. 5.5, pp. 8-10). MEC could have had similar results. It appears that MEC did not consider it worthwhile to investigate the costs of alternatives other than the GDMEC because it had already decided to construct GDMEC, regardless of the costs of alternatives.

C. AFUDC should not be recovered by MEC since MEC failed to gain approval of its affiliate interest agreement.

MEC argues that the Commission's rules do not support a disallowance of AFUDC because MEC was not required to obtain a construction permit from the State of Illinois and therefore there would be no starting point for the capitalization of interest. (MEC IB, pp. 27-28). MEC's argument is irrelevant. As Mr. Knepler clarified in his rebuttal testimony, he recommended that AFUDC not be accrued until MEC's affiliate assignment of the turbines was approved by the Commission. (ICC Staff Ex. 4.0., pp. 3 and 5). The basis for Mr. Knepler's position is that the Electric Plant Instruction 3 of the Uniform System of Accounts for Electric Utilities in Illinois (83 Ill. Adm. Code Part 415) does not allow recovery of AFUDC until approval is received from the Commission. The required approval is the approval of the affiliate interest agreement, not a construction permit.

Electric Plant Instructions, Components of Construction Costs (3)(17) states that:

* * *

> (17) Allowance for funds used during construction (Major and Nonmajor Utilities) includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed, <u>without prior approval of the Commission</u>, allowances computed in accordance with the formula prescribed in paragraph (a) of this subparagraph. No allowance for funds used during construction charges shall be included in

> these accounts upon expenditures for construction projects which have been abandoned.
>
> * * *

18 CFR 101, as of August 8, 2003. (emphasis added). Under Part 415, any references to "Commission" in 18 CFR 101 means "the Illinois Commerce Commission when not otherwise indicated in the context." (83 Ill. Adm. Code Section 415.200). Mr. Knepler recommended disallowance of AFUDC or capitalized interest related to the $56,163,538.66 of payments from MEC to Siemens Westinghouse, given that MEC had not received prior Commission approval. (ICC Staff Ex. 4.0, p. 5).

As Staff set forth in its initial brief, Mr. Knepler's recommendation interpreting Part 415 is supported by the Commission's order in the recent IPL affiliated interest docket. Staff in the IPL docket testified that some capitalized interest from the affiliate was assigned to IPL and further testified that AFUDC cannot accrue until the approval of the assignment from the Illinois Commerce Commission. (ICC Docket No. 02-0571, Order at 8-9 and at 10 (finding 5))[5]. To be consistent with the Commission's Uniform System of Accounts and the Commission's prior order in the IPL matter, the Commission should not approve the recording of $8,900,111 of AFUDC or capitalized interest related to the $56,163,538.66 of payments from MEC to Siemens Westinghouse and not approve any additional AFUDC related to other project costs for GDMEC.

[5] Finding 5 found the journal entries in IPL Exhibit 1.6 to be reasonable and consistent with the Uniform System of Accounts. (Order at 10). IPL Exhibit 1.6 which contained the journal entries proposed by IPL reflected no recording of interest payments to IPL's affiliate, Alliant Energy Resources (AER).

III. CONCLUSION

WHEREFORE, for the foregoing reasons and those previously stated in its initial brief, Staff respectfully requests that the Commission deny approval of MidAmerican's affiliated interest agreement and again deny MidAmerican's request for a declaratory ruling. If the Commission grants approval of Mid American's affiliated interest agreement, which it should not, Staff respectfully requests that the Commission find that (1) no AFUDC or capitalized interest related to the turbine agreement should be allowed recovery in any future rate proceedings, (2) the Commission is not approving in this proceeding the cost of the generating plants for rate recovery, (3) all records pertaining to the turbine agreement, and the assignment of such agreement, should be permanently maintained and (4) the Company's proposed journal entries to record the acquisition of the assets are appropriate, with the exception of the treatment of recording AFUDC.

Respectfully submitted,

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