STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	**:**	
	:	
Verified Petition for Declaratory Ruling or in the Alternative, Application for Approval of Affiliated Interest Contract.	**:**	**03-0496**

PROPOSED ORDER

By the Commission:

I. INTRODUCTION

On August 19, 2003, MidAmerican Energy Company ("MEC") filed with the Illinois Commerce Commission ("Commission") a verified petition for a declaratory ruling or, in the alternative, an application for approval of an affiliated interest contract. MEC made the filing pursuant to 83 Ill. Adm. Code 200.220, 83 Ill. Adm. Code 310.60, and Section 7-101(3) of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et seq. At the heart of this matter is MEC's acquisition of two Siemens Westinghouse 501F combustion turbines from its ultimate parent company, MidAmerican Energy Holdings Company ("MidAmerican Holdings"), in July of 2001. MEC sought a declaratory ruling that its acquisition of the turbines from MidAmerican Holdings was exempt from the need for Commission approval under the terms of Section 310.60 of Part 310, "The Waiver of Filing and the Approval of Certain Contracts and Arrangements with Affiliated Interests." If the Commission were to deny its request for a declaratory ruling, MEC requested that the Commission approve its acquisition of the turbines as an affiliate agreement pursuant to Section 7-101(3) of the Act.

Commission Staff ("Staff") filed a response to MEC's petition recommending that the request for the declaratory ruling be denied and that this matter proceed in a manner consistent with MEC's alternative request. MEC submitted a reply to Staff's response maintaining its support for its request for the declaratory ruling. Following the issuance of a Proposed Interim Order and the receipt of MEC's Brief on Exceptions and Staff's Brief in Reply to Exceptions, on January 7, 2004 the Commission entered an Interim Order denying the requested declaratory ruling on the basis of the written submissions before it in accordance with Section 200.220(h). The Interim Order also directed that this matter proceed as an application for approval of an affiliated interest contract under Section 7-101(3) of the Act.

Pursuant to due notice, hearings were held in this matter before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois on January 22, March 2, April 13, June 15, September 9, December 2, 2004, March 3, April 12, May 4, and July 14, 2005. Counsel for MEC and Staff each entered an appearance. No petitions to intervene were received. At the July 14, 2005 evidentiary hearing, Dean Crist, MEC's Vice President of Regulatory Projects, Dale Miller, MEC's Manager of Property Accounting, Jeffrey Greig, Manager of Project Development at Burns & McDonnell Engineering Company, Inc., and Irving Suss, owner and President of Continental Power Machinery Inc., testified on behalf of MEC. Greg Rockrohr, a Senior Electrical Engineer in the Electric Section of the Engineering Program of the Commission's Energy Division, and Steven Knepler, a Supervisor in the Accounting Department of the Commission's Financial Analysis Division, testified on behalf of Staff. At the end of the July 14, 2005 evidentiary hearing, the record was marked "Heard and Taken." MEC and Staff each submitted an Initial Brief and Reply Brief. On January 17, 2006, the Administrative Law Judge issued a ruling seeking comment on the question of the Commission's jurisdiction in this matter. MEC and Staff each submitted a response and a reply to each other's response. Thereafter, a Proposed Order was served on the parties.

II. MEC AND THE AFFILIATE TRANSACTION

According to the petition, MEC is an Iowa corporation with its principal office located in Des Moines, Iowa. As an electric public utility subject to the jurisdiction of the Commission within the meaning of Sections 3-105 and 16-102 of the Act, MEC is engaged in the business of producing, transmitting, and delivering electricity to the public in Rock Island, Henry, Whiteside, and Mercer counties in Illinois and in other states. Approximately 10% of MEC's 2002 revenues from electric service were derived from customers in Illinois. MEC notes that it is also subject to the jurisdiction of the Federal Energy Regulatory Commission, the Iowa Utilities Board, and the South Dakota Public Utilities Commission.

MEC is a direct wholly-owned subsidiary of MHC Inc., which in turn is wholly-owned by MidAmerican Funding, LLC. MidAmerican Funding, LLC is a direct, wholly-owned subsidiary of MidAmerican Holdings. In light of these relationships, MEC acknowledges that it is an affiliated interest of MidAmerican Holdings under Section 7-101 of the Act.

Along with its petition, MEC submitted the prepared testimony and affidavit of Dean Crist. Mr. Crist testifies that MidAmerican Holdings conducted a solicitation process in the third quarter of 1999 to obtain the combustion turbines. He states that there were three potential vendors for combustion turbines of desired capacity and performance: ABB, General Electric ("GE"), and Siemens Westinghouse. MEC contacted each of these potential vendors. Mr. Crist testifies that ABB was only providing units as a part of a turnkey package, which would include a complete plant (combustion turbine, steam turbine, and heat recovery steam generator) with 2003 and later deliveries and there were reported operating problems with previous ABB engines. For these reasons, Mr. Crist reports that ABB was eliminated from consideration. With regard to GE, he states that it was not able to provide a quote with the requested delivery schedule due to its order backlog. Siemens Westinghouse did have manufacturing capability to provide units with delivery in 2002. Mr. Crist indicates that the units were to be a design similar to the Cordova Energy Center. Because of the delivery and compatibility advantages, Siemens Westinghouse was selected as the supplier and negotiations were undertaken.[1] During the negotiations, Mr. Crist testifies that the experience gained from the Cordova Energy Center combustion turbine procurement was used to optimize the design and pricing of the units given market conditions at the time. He indicates that the negotiation process was completed and a contract ("Turbine Agreement") was signed on May 26, 2000. The total contract price was $70,034,335, and was subsequently revised to $71,736,708. Sales tax amounted to an additional $5,947,843.

Mr. Crist asserts that MidAmerican Holdings did not acquire the combustion turbines specifically for MEC. MidAmerican Holdings acquired the turbines for its CalEnergy-Domestic and CalEnergy-International business platforms. Through these platforms, MidAmerican Holdings has constructed and owns and operates 19 generating plants (15 in the United States and four in the Philippines). After MidAmerican Holdings executed the Turbine Agreement with Siemens Westinghouse, however, MEC's need for the turbines for its Greater Des Moines Energy Center ("GDMEC") project advanced more rapidly than MidAmerican Holdings' need for the turbines. He states that the GDMEC project advanced due to the enactment of Iowa legislation (House File ["HF"] 577) that removed certain disincentives to investor-owned utilities constructing and owning new generation within Iowa. Consequently, MidAmerican Holdings and MEC agreed to transfer the Turbine Agreement. Mr. Crist testifies that MEC reimbursed MidAmerican Holdings for its costs with six payments totaling $21,521,012 that occurred from June 2000 through July 2001 from MidAmerican Holdings to Siemens Westinghouse. He adds that MEC compensated MidAmerican Holdings for capitalized interest of $488,004 and for miscellaneous expenses of $2,245.70. The allocation of the capitalized interest and miscellaneous expenses was recorded below-the-line so that no part of this expense would be reflected in base rates for Illinois customers.

Under his direction, Mr. Crist states that available options for acquiring turbines for the GDMEC project were reviewed. In light of MidAmerican Holdings' aforementioned experience in acquiring the two turbines, Mr. Crist testifies that Siemens Westinghouse was the only viable option for a turbine generator. In order to meet the projected "in-service" dates for the GDMEC project, he states that the decision was made to take assignment of the turbines from MidAmerican Holdings in July 2001. The first phase (simple cycle operation) of GDMEC was constructed and began commercial operation prior to the summer of 2003.

In its Reply Brief, MEC reports that on July 29, 2005, the Iowa Utilities Board approved the allocation of all rate base associated with GDMEC to MEC's Iowa jurisdiction. Specifically, MEC is to reallocate to Iowa electric customers all GDMEC capital costs and expenses that had been allocated to Illinois customers. MEC will accrue allowance for funds used during construction in Iowa that would have been allocated in Illinois. The Iowa Utilities Board determined that this reallocation will permit MEC to provide electric service to a new customer, IPSCO Steel, Inc. in Muscatine County, Iowa, beginning October 1, 2005. (See Iowa Utilities Board Docket Nos. SPU-05-9 and SPU-05-12)

[1] Siemens Westinghouse is not an affiliated interest of MEC or MidAmerican Holdings.

III. GOVERNING LAW

Section 7-101 of the Act governs transactions among affiliated interests. Subparagraph (3) provides:

> (3) 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. Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.
>
> The consent to, or exemption or waiver of consent to, any contract or arrangement under this Section or Section 16-111, does not constitute approval of payments thereunder for the purpose of computing expense of operation in any rate proceeding. However, the Commission shall not require a public utility to make purchases at prices exceeding the prices offered by an affiliated interest, and the Commission shall not be required to disapprove or disallow, solely on the ground that such payments yield the affiliated interest a return or rate of return in excess of that allowed the public utility, any portion of payments for purchases from an affiliated interest.

Staff and MEC agree that the “public interest” standard established in Section 7-101(3) has not been specifically defined by statute, case law, or prior Commission decisions. They also agree that the “public interest” standard accords broad discretion to the Commission and at times has been used interchangeably with the “public convenience” standard used elsewhere in the Act (e.g.: Section 7-102). What they do not agree on is exactly how to apply the standard in this proceeding.

IV. WHETHER THE AFFILIATE TRANSACTION IS IN THE PUBLIC INTEREST

A. Staff’s Position

Staff argues that MEC has failed to meet the requirements of Section 7-101(3). Staff witness Rockrohr’s analysis of whether MEC’s affiliate interest agreement should be approved consists of three steps.[2] The first step in his analysis was to determine whether MEC had demonstrated that it needed additional capacity prior to the summer of 2003. The second step, which is the most contested issue in the proceeding, was to determine whether MEC had demonstrated that its construction of utility owned generation plant was the least cost alternative to obtain additional capacity. The third step in Mr. Rockrohr's analysis was to determine whether MEC had demonstrated that the price paid for the turbines to its affiliate did not unfairly benefit that affiliate.

As a result of step one of his analysis, Mr. Rockrohr testifies that MEC failed to demonstrate that it needed additional capacity prior to the summer of 2003. MEC's own exhibits, Staff argues, support Mr. Rockrohr's position on this issue. According to Staff, Table 1 in MEC's Exhibit No. 5.1, titled, "MidAmerican Energy Company Load and Capability–August 31, 2001 Excluding Greater Des Moines Energy Center," does not indicate that MEC needed additional capacity prior to the summer of 2003 to meet its load and reserve requirements. MEC states it uses a "hot weather" forecast to guard against its actual loads exceeding its Mid-Continent Area Power Pool ("MAPP") reserve requirement. Using MEC's planning method, Mr. Rockrohr states that Table 1 appears to indicate MEC would have adequate capacity to meet customer load and MAPP reserve requirements (without GDMEC's capacity) until MEC's purchase agreement with Cordova Energy Company ("CEC") expired in May of 2004.

The most contested issue in the proceeding relates to the second step in Mr. Rockrohr's analysis. He testifies that MEC did not provide evidence that constructing GDMEC prior to the summer of 2003 was the least-cost alternative to obtain additional electric generating capacity. Mr. Rockrohr points out that at the time MEC made its decision to acquire the combustion turbines in 2001, MEC decided to cancel an existing request for proposal ("RFP") for purchased power, and thereby lost an important opportunity to obtain cost information on alternative sources of electric generation capacity. Mr. Rockrohr argues that MEC's purchase of the two combustion turbines could not be in the public interest if MEC's construction of GDMEC, as a whole, were not prudent. He indicates that MEC's construction of GDMEC can not be considered prudent and useful if lower cost alternatives existed that offered the same benefits to MEC's customers. Mr. Rockrohr testifies further that MEC did not investigate whether lower cost alternatives existed prior to constructing GDMEC. Staff notes that Mr. Crist does not dispute Mr. Rockrohr's testimony that MEC did not conduct an RFP. Staff's position is that an RFP for wholesale purchases would be the most straight forward way for MEC to demonstrate that its proposed capacity additions will be the least cost means to meet the needs of its customers. If an RFP is not conducted, Staff asserts that MEC would need to demonstrate through some other method that the capacity additions would be the least cost means to meet the needs of its customers. Mr. Rockrohr testifies that MEC could have met its capacity needs in a number of ways, including, but not limited to, the use of purchase agreements, the construction of the generating plant by some other entity with the eventual sale of the facility to MEC, the

[2] Staff asserts that MEC does not dispute that steps 1 and 3 were appropriate issues for Mr. Rockrohr to consider in his analysis given that MEC offered testimony on those issues as part of its direct and rebuttal case (MEC Ex. 1.0, pp. 5-7, 11-13 and Ex. 5.0, p. 2); MEC however skips step 2.

renewal or extension of one its expiring purchase agreements, or any various combination of these alternatives.

Staff perceives MEC's failure to consider alternatives to be directly related to the change in Iowa law, HF 577, and Iowa's rate treatment of new utility-owned generation units. Mr. Rockrohr discussed legislative changes in Iowa and their impact on MEC's decision to acquire the Turbine Agreement from MidAmerican Holdings. Mr. Rockrohr testifies that HF 577 significantly changed the rate treatment Iowa utilities receive when proposing/building generating facilities. Prior to HF 577, a utility in Iowa that built a generating facility would learn the return it would be allowed for its investment during rate proceedings after plant completion. HF 577 allows Iowa utilities to learn the allowed rate of return for investments in new utility-owned generation prior to start of construction. Upon learning the allowed return on investment, Iowa's utilities can then decide whether to proceed with the utility-owned generation project, or to withdraw the project and obtain the necessary capacity from another generation alternative, such as through purchase power agreements. Iowa's governor signed HF 577 on July 3, 2001. Staff reports that the Turbine Agreement was transferred to MEC less than 3 weeks after the change in Iowa law. Mr. Rockrohr states that MEC appeared to have been so focused on opportunities relating to new utility-owned generation resulting from HF 577 that it neglected to seriously consider any other alternatives. In fact, Staff adds, MEC stated it had previously issued a RFP to solicit bids from various power producers to meet its capacity needs. As a result of HF 577, MEC cancelled its RFP for purchase power because it planned to go forward with its own project. Staff believes that the RFP cancellation by MEC eliminated an opportunity for MEC or regulators to compare the costs associated with building GDMEC to the costs associated with other alternatives. Mr. Rockrohr states further that in Iowa there is a different standard than in Illinois for a utility to demonstrate that it also considered other sources for long-term supply. In Iowa, the utility-owned generator need not be the least-cost alternative, but rather the utility's proposed facility need only be shown to be reasonable when compared to other alternatives.

In addition to the change in Iowa law, Staff contends that there were other considerations which may have moved MEC to enter into a contract with its affiliate. Mr. Rockrohr is concerned that MEC chose to enter into a contract with its affiliate to (1) relieve MidAmerican Holdings from its obligation to purchase turbines that it no longer needed and to reimburse it for its out-of-pocket costs associated with the purchase which totaled $21.5 million and (2) provide MEC's shareholders a more favorable return on investment than other alternatives due to the provisions of Iowa's HF 577. Mr. Rockrohr has additional concerns with MEC's decision to enter into its affiliate contract and to construct GDMEC. Those concerns include his observation that (1) many of the same individuals involved in the decision making were executives/directors representing the interests of more than one of the affiliate entities involved in the transaction (MEC and CEC are affiliates, and both are subsidiaries of MidAmerican Holdings) and (2) MEC did not compare GDMEC costs to the costs of actual purchase agreements. In Docket No. 00-0197, in which MEC obtained Commission approval for its affiliate agreement with CEC for power purchases, Staff relays that MEC witness William Turnbull testified that MEC successfully sought to reduce the term of its purchase agreement with CEC, which began in June of 2001, from five years to three years.[3] In this proceeding, Staff observes that Mr. Crist stated that MEC needed additional capacity, in part, due to the expiration of its purchase agreements with CEC (for approximately 250 megawatts ["MW"] of capacity) and with Nebraska Public Power District ("NPPD") (for approximately 379 MW of capacity). Staff complains that MEC did not compare the capacity and energy costs associated with constructing GDMEC to the cost associated with renewing or extending its contract with CEC. Then, after it constructed GDMEC, to meet its additional capacity needs in 2005, Staff points out that MEC again entered into a contract to purchase capacity from NPPD (for approximately 250 MW of capacity).

With respect to the third step in his analysis, i.e., whether MEC demonstrated that the price paid for the turbines to its affiliate did not unfairly benefit its affiliate, Mr. Rockrohr opines that the price that MEC paid for the two combustion turbines through the Turbine Agreement was at or below market prices in 2001. As discussed above, however, Staff believes that the fact that MEC paid a market rate for the turbines by itself does not meet the public interest requirement of Section 7-101(3) and therefore does not provide support for approval of the assignment of the Turbine Agreement. Even if there was a need for additional capacity prior to the summer of 2003, which MEC failed to demonstrate, Staff contends that it is irrelevant whether the price paid for the turbines was a market rate if there was a less costly alternative to meeting the need which MEC never considered.

Staff also points out that Mr. Rockrohr's analysis in this docket is the same analysis that he used in a recent proceeding which involved another Iowa utility that serves Illinois customers, Interstate Power and Light Company ("IPL"). In Docket No. 02-0571, IPL, like MEC, was motivated to build its own generating plant for the benefit of shareholders after the passage of HF 577 in Iowa. In Docket No. 02-0571, IPL sought approval to purchase the components for a generating station through the use of a contract that was previously entered into by its unregulated affiliate. The first issue that Mr. Rockrohr analyzed in that docket was whether IPL had demonstrated a need for the additional capacity. The second issue he analyzed was whether IPL's own building of the generation station was the least cost option. If it was not, then Mr. Rockrohr concluded that some company other than IPL should be building the facility and as a result IPL would have no need for the equipment which it was acquiring from its affiliate. In the IPL matter, IPL provided Mr. Rockrohr with a copy of its RFP, all the proposals submitted in response to the RFP, and its own utility proposal. The third issue Mr. Rockrohr analyzed was whether the price paid would unfairly benefit IPL's affiliate. On March 18, 2003, the Commission entered an Order in Docket No. 02-0571 approving IPL's affiliate agreement with Staff's support and subject to certain conditions recommended by Staff.

In addition, Staff takes MEC to task for not seeking Commission approval before agreeing to the assignment of the Turbine Agreement from its affiliate. Staff argues that 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

[3] ICC Docket 00-0197, MidAmerican Exhibit 2.0, filed March 1, 2000, page 23, lines 9-20.

turbines and constructing GDMEC. The failure to ask the Commission for advance approval should not, Staff continues, shield MEC from the Commission applying the appropriate analysis of MEC's affiliate interest agreement.

In light of the decision to allocate all rate base associated with GDMEC to its Iowa jurisdiction, Staff understands MEC to suggest that the Commission does not have authority to review the assignment of the Turbine Agreement from MidAmerican Holdings. Staff counters that MEC cites to no authority, and Staff is aware of no precedent which would indicate that Commission approval under Section 7-101 is necessary only when the utility plans to attempt to recover the cost of the affiliate agreement from ratepayers. Staff points out that the language in Section 7-101 is clear that "No … contract … made with 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." MEC's apparent interpretation of Section 7-101 is not consistent with that language, according to Staff. If the Commission were to accept MEC's view of this matter as being correctable by a simple "asset carve-out," (i.e. allocating all the asset's costs to Iowa) Staff fears that such a solution would essentially mean that any utility could engage in any conduct it wished with an affiliate, as long as the utility could, when caught, create an accounting mechanism that would no longer allocate identifiable costs associated with that conduct to its Illinois customers' rates. Staff does not accept the position that such an approach resolves all potential concerns. To do so, Staff argues, would be to ignore the possibility that a utility might be weakened by affiliate transactions in ways that could impact service quality, or the financial well-being of the utility, or both, without these problems ever directly involving the recovery by the utility, in rates, of expenses stemming from the illegal affiliated interest transaction.

B. MEC's Position

MEC questions whether the Commission even has authority over its affiliate agreement with MidAmerican Holdings. According to MEC, Section 7-101 of the Act does not provide the Commission with the authority to approve affiliated interest transactions if the costs are not included in Illinois rates. MEC maintains that as of October 1, 2005, the Commission no longer had jurisdiction over GDMEC or the assignment of the Turbine Agreement because on that date the Iowa Utilities Board's acceptance of the allocated costs of GDMEC otherwise chargeable to Illinois became effective. If the Commission determines, however, that it still must consider whether the assignment of the Turbine Agreement is in the public interest, MEC argues that the Commission is not bound by any prior decision as controlling precedent. MEC believes that the record demonstrates 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. If the Commission is inclined to adopt Staff's methodology, MEC encourages the Commission to undertake a broad review of all potentially relevant facts and circumstances.

MEC states that in the Interim Order at page 8, the Commission suggests closer scrutiny of whether Siemens Westinghouse turbines would have been selected had MEC undertaken a separate competitive solicitation in the summer of 2001. MEC contends that it provided the necessary evidence to justify this conclusion in the form of additional testimony from independent power supply experts Irving Suss and Jeffrey Greig. Both independent experts, MEC asserts, confirm that MidAmerican Holdings' 1999 solicitation represented a complete review of potential turbine vendors that would have had suitable units available to MEC in 2001. Both also confirm, MEC continues, that the Siemens Westinghouse machines would have been the only available option to meet MEC's needs, even if a separate solicitation had been conducted in 2001. 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. Both experts testified that in 2001, the same concerns continued to exist with GE units (backlog) and ABB units (turnkey installation, quality problems) that had caused MidAmerican Holdings to steer clear of them in 1999.

MEC also notes that the Interim Order suggests an infirmity in the verified affidavits submitted with the petition. The Interim Order indicates 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 observed that 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, Mr. Suss and Mr. Greig stated that all models had been considered in their original assessments of market price. Mr. Greig acknowledged that his original price analysis was only for the Siemens Westinghouse unit, but that the files he had reviewed in his independent assessment included a similar combustion turbine unit manufactured by GE, the GE 7FA. 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. MEC maintains that the sworn testimony of these experts demonstrates that their analyses broadly examined all applicable turbine makes and models. This, MEC believes, fulfills the Commission's concern expressed in the Interim Order.

The only remaining inquiry, according to MEC, is whether the price for the Siemens Westinghouse units was within the range of the market price that MEC would have paid absent the assignment of the Turbine Agreement. There is no dispute by the parties to this proceeding that MEC paid market price or below for the combustion turbines. MEC points out that 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. 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 argues that these prices demonstrate the contract assignment was a beneficial investment for MEC and its customers. As a result of its decisions, MEC observes that it was able to procure turbines in an extremely tight market and, just as importantly, in a timely manner to meet customer and system reliability needs. For these reasons, MEC concludes that the affiliated interest transaction is in the public interest and should be approved.

Additionally, had it delayed construction of GDMEC until 2004, MEC maintains that the price of the turbines would not have been substantively different, as it understands Staff to suggest. Mr. Crist testified that the 2001 Load and Capability Study caused MEC to determine capacity was required by the summer of 2003. MEC states, however, that review of its “hot weather” forecast for 2003 actually shows a very slim margin of 6 MW above required minimum reserves, which does not take into consideration the various contingencies outlined by Mr. Crist. MEC understands Mr. Rockrohr to suggest that the 2001 Load and Capability study demonstrates that MEC could have got along without GDMEC in 2003. But as Mr. Suss testified, turbine demand was strong throughout 2001. In order to procure a turbine for delivery in early 2004, MEC states that it would likely have had to commit to a turbine by the end of 2001. MEC contends that the strong demand through all of 2001 suggests that even if it 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 Agreement. Accordingly, MEC argues that its 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.

With regard to Staff’s position, MEC maintains that the Commission should not adopt Mr. Rockrohr’s suggestion to expand review of the affiliated interest transaction to encompass considerations of the price and need for GDMEC. Mr. Rockrohr concurs with MEC that the price it paid for the turbines was at or below market value, but to MEC’s consternation focuses on the overall need for GDMEC. He argues that the Turbine Agreement assignment can not be in the public interest if construction of GDMEC as a whole was not prudent. MEC understands Staff to argue that such an inquiry into GDMEC is appropriate because costs associated with GDMEC, either direct or indirect costs, may be included in Illinois rates. MEC insists, however, that this concern should not exist in light of the express provisions of Section 7-101(3) and the recent action of the Iowa Utilities Board in Docket Nos. SPU-05-9 and SPU-05-12.

Similarly, MEC considers Staff’s reliance on Section 9-211 of the Act misplaced. This section provides that only the value of investments that are prudently incurred and used and useful may be included in rate base. MEC understands Staff to be reading into Section 9-211 a requirement that a RFP be issued before generation investment can be included in rates. MEC argues that no such requirement exists and points out that according to Illinois Power Company v. Illinois Commerce Commission, 339 Ill. App. 3d 425, 790 N.E. 2d 377 (1st Dist. 2003), different analytical methods can be used to lead to a conclusion that a utility investment is reasonable.

Despite the conclusions in Illinois Power, MEC complains that Staff proceeds to evaluate the Turbine Agreement assignment using only one methodology. MEC characterizes Staff’s three-part test as rigid and asserts that Staff’s test ignores other potential interpretations of the “public interest” standard. MEC maintains that Staff’s method requires a determination of whether MEC has demonstrated need for the Iowa generator under what Staff claims are the standards of Illinois law.

But even if Staff is correct in using the criteria it has identified, MEC argues that its affiliate transaction still passes Staff’s test. MEC understands the first prong of Staff’s test to involve a determination of whether GDMEC’s capacity was needed by the summer of 2003. If GDMEC was not needed until a later time, Staff reasons that it would not have been necessary for MEC to procure turbines during the summer of 2001 and could have bought turbines later on the open market. Although Staff concludes that MEC had sufficient capacity resources, MEC contends that Staff's analysis ignores (1) the extreme weather forecast for 2003 that showed a 255 MW deficit; (2) the hot weather forecast for 2003 that showed a slim margin of 6 MW over MAPP required reserves (which MEC states would not have been sufficient to meet its needs in the event of an unforeseen outage of a generator); and (3) the lack of precision in reserve requirements between reliability authorities. MEC also states that the Des Moines, Iowa area, where GDMEC is located, is its largest load center. At the time of the decision to construct GDMEC, MEC explains that only a minor amount of generation capacity existed in this area. The lack of local generation, MEC continues, caused it to rely heavily on its transmission system to serve the Des Moines area load. Transmission bottlenecks led MEC to determine that location of a generation resource close to the load center was required at that point in time. With this in mind, MEC concludes that the prudent utility executive could only make one decision in the summer of 2001 and that was to build generation, not to wait another year.

MEC understands the second prong of Staff's test to be whether it proved GDMEC was the least cost alternative to obtain additional electric generating capacity. Although Staff considers a RFP to be the most straight forward means of demonstrating least cost, it acknowledges that other methods could work. MEC, however, criticizes Staff's preference for a RFP and asserts that HF 577 made RFP results suspect. Instead of a RFP, MEC suggests comparing the cost of GDMEC to the cost of IPL's Power Iowa Energy Center, a gas-fired generating plant built around the same time as GDMEC. Mr. Crist testifies that the two units have very similar costs. He states that the per-kilowatt price difference of the two units is approximately two percent. In response to Staff's suggestion that the costs of the two units are not comparable because the IPL construction included "site specific" costs not reflected in GDMEC, MEC asserts that both utilities had valid reasons for selecting their sites. MEC contends that excluding costs associated with one generator leads Staff down a slippery slope and makes its comparison suspect.

The third prong of Staff's test is whether the price paid for the turbines was at or below market price. MEC reiterates that there is no dispute that this prong is satisfied. MEC states that two independent experts support Mr. Crist's testimony that MEC acquired the turbines from its affiliated interest at a reasonable price.

Ultimately, MEC urges the Commission to reject Staff's claim that MEC failed to follow Illinois law when it decided to take assignment of the Turbine Agreement. MEC states that Staff does not identify any such requirement in Illinois law. MEC contends that this is important because, although Illinois has no state preference or requirement for in-state generation, Iowa does—and Staff fails to recognize that preference and accord it appropriate comity. If the Commission is to provide fair and equitable regulation of multi-state utilities, MEC argues that it must recognize and reconcile the potentially competing obligations of all states served by such utilities. Failure to do so, MEC continues, effectively denies utilities a reasonable opportunity to operate in interstate commerce. Furthermore, MEC maintains that taking a rigid approach does not allow the Commission to make a fair assessment of whether the actions the utility did take (as opposed to the process it did not adopt) are in the public interest.

C. Commission Conclusion

One of the purposes of Section 7-101 of the Act is to protect Illinois ratepayers, as well as the regulated utility itself, from the negative consequences of transactions between the regulated utility and an affiliate. This purpose should be kept in mind when resolving this matter. At issue in this proceeding is whether MEC's acquisition of two gas turbines from its ultimate parent, MidAmerican Holdings, is in the public interest pursuant to Section 7-101(3) of the Act. As noted above, the "public interest" standard established in Section 7-101(3) has not been specifically defined by statute, case law, or prior Commission decisions, but does accord broad discretion to the Commission. The fact that the gas turbines are located in Iowa and not intended to serve or otherwise benefit Illinois ratepayers does not render Section 7-101(3) inapplicable since this statutory provision contains no such limiting language. Accordingly, the Commission must make use of its discretion and make findings pursuant to Section 7-101(3) of the Act.

In light of the specific circumstances present, the Commission has decided that in using its discretion in evaluating the public interest it is appropriate to focus on the impact of the affiliate transaction on Illinois ratepayers. On October 1, 2005, the Iowa Utilities Board's decision in Docket Nos. SPU-05-9 and SPU-05-12 became effective, resulting in the reallocation to Iowa electric customers all GDMEC capital costs and expenses that had been allocated to Illinois customers. The Iowa Utilities Board decision also concluded that MEC will accrue allowance for funds used during construction in Iowa that would have been allocated in Illinois. MEC concedes that the only remaining cost potentially affecting Illinois ratepayers is the fuel cost for GDMEC, but anticipates that being addressed in MEC's next fuel adjustment clause ("FAC") reconciliation proceeding. So long as the Iowa Utilities Board does not reverse the allocation of GDMEC costs determined in Docket Nos. SPU-05-9 and SPU-05-12 and fuel costs for GDMEC are excluded from the FAC calculation for Illinois ratepayers, the Commission concludes that Illinois ratepayers will not be adversely impacted by the assignment of the Turbine Contract from MidAmerican Holdings to MEC. Accordingly, the Commission finds the affiliate transaction to be in the public interest consistent with the Section 7-101(3) of the Act.[4]

In coming to this conclusion, the Commission does not mean to imply that it has reconsidered Staff's analysis in Docket No. 02-0571, concerning an IPL generating facility in Iowa. Docket No. 02-0571 is distinguishable from this proceeding in that IPL expressed an intent to use its new generation facility to benefit Illinois ratepayers and eventually include it in its Illinois jurisdictional rate base. MEC has expressed its intent to not do so.

[4] The Commission acknowledges that the reallocation of costs associated with GDMEC from Illinois to Iowa customers was discussed in this proceeding prior to the decision of the Iowa Utilities Board in Docket Nos. SPU-05-9 and SPU-05-12.

The Commission also does not mean to imply that it condones MEC's handling of this matter. The Commission still can not conclude that the transaction in question is in the ordinary course of business. Despite its protestations to the contrary, MEC should have come to the Commission under Section 7-101(3) and sought approval of the assignment of the Turbine Agreement before transferring the agreement from MidAmerican Holdings. Anytime MEC experiences any doubt about whether an affiliate transaction needs Commission approval, MEC should err on the side of caution and submit a petition pursuant to Section 7-101. Further aggravating the situation is MEC's decision to wait until approximately two months after GDMEC began operating to initiate this proceeding. MEC should consider itself warned that it must not treat transactions with its affiliates so casually.

The Commission also questions MEC's claim that GDMEC was built solely to serve load and alleviate transmission constraints in the Des Moines area. This assertion seemed plausible until it was revealed that MEC requested the relief it eventually received from the Iowa Utilities Board in Docket Nos. SPU-05-9 and SPU-05-12 in part to provide retail electric service to IPSCO Steel, Inc. in Muscatine County, Iowa. Muscatine County borders the Mississippi River and as such is more than 100 miles from Des Moines. How serving an industrial facility in Muscatine County is consistent with meeting the growing needs of the Des Moines area and alleviating transmission constraints is not clear to the Commission. This and other shortcomings in MEC's defense of its affiliate transaction, however, do not lead the Commission to deny approval because in this situation any problems that may arise will not adversely affect Illinois ratepayers.

MEC is also advised not to attempt to avoid Commission review of affiliate transactions in the future by simply trying to remove any direct costs of the transaction from Illinois rates. The specific circumstances surrounding the construction of GDMEC and the assignment of the Turbine Agreement do not lend themselves to such a generalization. While the direct costs of a future affiliate transaction may be removable from Illinois rates, indirect costs to Illinois ratepayers may not be readily discernible or removable. The Commission, not MEC, must decide if Section 7-101 is applicable and satisfied. Because Illinois ratepayers will not be responsible for costs associated with the turbines, including fuel costs, the Commission has decided in this situation that consent to the affiliate transaction is warranted.

V. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having reviewed the entire record and being fully apprised in the premises, is of the opinion and finds that:

(1) MEC is an Iowa corporation, engaged in the sale of gas and electricity to the public in the State of Illinois, and is a public utility within the meaning of the Act;

(2) the Commission has jurisdiction over the parties hereto and the subject matter hereof;

(3) the recitals of fact and conclusions reached in the prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact;

(4) MEC's request for approval of assignment of the Turbine Agreement from MidAmerican Holdings is in the public interest within the meaning of Section 7-101 of the Act and should be approved so long as no costs, direct or indirect, associated with GDMEC are imposed on Illinois ratepayers, such costs include fuel costs; and

(5) approval of this affiliate transaction does not have any precedential affect on any future affiliate transaction or Commission orders.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the assignment of the Turbine Agreement from MidAmerican Energy Holdings Company to MidAmerican Energy Company is hereby approved and consented to pursuant to Section 7-101 of the Public Utilities Act, subject to the condition described in Finding (4) and the prefatory portion of this Order.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

DATED: February 8, 2006

Briefs on Exceptions must be received by February 24, 2006.
Briefs in Reply to Exceptions must be received by March 3, 2006.

Administrative Law Judge