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Missouri Public Service Commission

Mr. Dale Hardy Roberts
Executive Secretary
Public Service Commission
Governor State Office Building
Jefferson City, Missouri

RE: Case No. EA-2000-308
In the Matter of the City of Rolla, Missouri

Dear Mr. Roberts:

Enclosed for filing in the above-referenced proceeding please find an original and eight copies of the initial brief of the City of Rolla, Missouri.

If you have any questions, please give me a call.

Sincerely yours,

Gary W. Duffy

Enclosures
cc w/encl:
Ruth O'Neill, Office of Public Counsel
Dennis L. Frey, Office of the General Counsel
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Michael R. Dunbar
Dan Watkins

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BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the matter of the application of the City of Rolla, Missouri, for an order assigning exclusive service territories and for determination of fair and reasonable compensation pursuant to section 386.800 RSMo 1994.	))))))	Case No. EA-2000-308

INITIAL BRIEF OF

THE CITY OF ROLLA, MISSOURI

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Rolla Municipal Utilities

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1. Introduction

This is a case of first impression. The Commission has never had a case under the ten year old provisions of § 386.800 RSMo go to hearing and require a decision. There are long-term ramifications of its decision on the Rolla area, and potentially other areas of the state if cases such as this are later brought by other municipal utilities.

The fundamental question is whether the Commission should force a transfer of approximately 286 of Intercounty Electric Cooperative Association's ("IEC" or "Intercounty") customers, and associated facilities, which are now located within the corporate limits of the City of Rolla ("City" or "Rolla") to Rolla's municipally owned and operated electric utility, Rolla Municipal Utilities ("RMU"). The answer is yes because the transfer eliminates a number of problems and provides a positive overall benefit to the public. If the Commission does not order the transfer, it will perpetuate problems which the General Assembly wishes to avoid.

Existing statutes show the General Assembly prefers competing electric service providers to settle territorial disputes or make allocations of territory among themselves when their distribution facilities overlap through territorial agreements. These agreements for apportioning territory between competitors are authorized in general by § 394.312 RSMo.[1] That section, enacted in 1988, contains a "permissive" approach since it allows two competitors to reach an agreement on their own about how to divide territory in which each is authorized to provide electric service. To satisfy anti-trust problems of two competitors allocating customers among

[1] References to RSMo are to RSMo 1994 unless otherwise stated.

themselves, the statute provides that the Commission is to take an active role[2] in approving the territorial agreement. § 394.312.5 RSMo. The standard the Commission is required to apply to a voluntary agreement is whether it is "not detrimental to the public interest." § 394.312.4 RSMo. Under that provision, there have been several territorial agreements approved by the Commission in the past dozen years.

Building on the concept of territorial agreements in § 394.312 RSMo, the General Assembly enacted different provisions (§ 386.800 RSMo) in 1991 which, unlike the *voluntary* aspect of § 394.312 RSMo, contain a *mandatory* requirement for negotiation of a territorial agreement between a municipal utility and another utility with facilities in an area annexed by a city. Section 386.800 RSMo also contains a provision which, in essence, says that if a voluntary agreement cannot be worked out, the municipal utility can ask the Commission to establish an exclusive service territory for the municipal utility in the annexed area and force the sale of the facilities of the pre-existing utility (either a rural electric cooperative or an investor-owned utility, or both). The Commission is given the authority to determine if the particular situation is in the public interest and to set the price and order the transfer. § 386.800 RSMo.

Rolla has presented substantial evidence that it is in the public interest for the Commission to approve its application and order the transfer of the IEC facilities within the Southside area which was annexed in mid 1998. The public will be benefitted by such approval in the following respects:

✓ Over 250 IEC customers will immediately experience a 25 percent reduction in residential electric rates.

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[2] This provides a "state action" exemption under state and federal anti-trust laws.

✓ Residents in several subdivisions in the Southside area will not face the prospect of two sets of overhead electric distribution lines (e.g. one in the front yard and one in the back yard) in their neighborhood.

✓ All of the customers of Rolla Municipal Utilities (some 7,800) and all of the customers of IEC (some 27,800) will be freed of the unnecessary costs of each supplier to maintain dual or duplicate facilities in the Southside area because there will be more efficient utilization of only one set of lines.

✓ All of the members of the public will have a reduced risk of colliding with utility poles in the Southside area, because there will be fewer such poles.

✓ All of the members of the public will have a reduced risk of serious injury or even death from coming into contact with overhead electric lines in the Southside area, because there will be fewer such lines and poles.

✓ All of the line workers of IEC and RMU will have a reduced risk of serious injury or death from work-related incidents in the Southside area, because there will be fewer such lines, poles, transformers, and other equipment.

✓ The City of Rolla, for the first time since the annexation, will be able to start obtaining the same level of revenue (in the form of a PILOT from the 286 IEC customers) that it has been receiving from the other 7,800 electric customers within the City; thus eliminating a disparity in the treatment of electric customers in the City.

✓ The clear and obvious intention of the General Assembly to allow municipal utilities to expand their service areas, coincident with municipal annexation, will be observed and RMU will be able to spread its fixed costs over more units, to the benefit of its customers.

2. Factual Background

3. Chronology of Events

This case comes before the Commission only after a very lengthy process, most of which involves steps mandated by the Missouri General Assembly. The first part of the process was a municipal annexation which must proceed according to certain statutory provisions. After the annexation is approved by the voters, another and different set of statutory procedures is required for the municipal utility to expand its service area to serve structures which have been served by another supplier.

On October 7, 1996, the City Council of the City of Rolla, by ordinance, declared its intent to annex approximately 1350 acres on the south side ("Southside area" or "annexed area") of the city. (*See*, Rolla's Application, Appendix A, p. 1) The question of the annexation was put to a vote on April 7, 1998. (Tr. 313) It passed. The annexation became effective 60 days later on June 7, 1998.[3] § 71.015 RSMo.

Afterwards, all of the requirements in § 386.800 RSMo as a prerequisite to the filing of an application with the Commission were met by Rolla. Rolla complied with subsection 3 of § 386.800 RSMo in the following manner: Within 60 days of the effective date of the annexation, it caused to be published (on July 15, 1998) a notice to the record owners of structures in the annexed area in a newspaper of general circulation. (Ex. 5, p. 10) A copy of that public notice was attached as Appendix D to the application filed with the Commission on October 29, 1999.

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[3] Sixty days from April 7 is actually Saturday, June 6, 1998. References at the hearing and in testimony of several parties to the annexation being effective on June 7 or June 8 is probably harmless error in this situation.

Rolla notified in writing the only affected electric supplier (IEC) on July 13, 1998. (Ex. 5, p. 10) A copy of that notice was attached as Appendix E. Rolla notified the Commission in writing on July 13, 1998. (Ex. 5, p. 10-11) A copy of that notice was attached as Appendix F. Rolla Municipal Utilities also received the approval of the City's governing body (the city council) to begin negotiations pursuant to § 394.312 RSMo, with IEC, the affected supplier. (Ex. 5, p. 11) A copy of that authority was attached to the application as Appendix G. None of these filings have been disputed by IEC.

Rolla also complied with subsection 4 of § 386.800 because it participated in numerous negotiation and discussion sessions with representatives of IEC concerning a possible territorial agreement for the annexed area and other areas around the City. (Ex. 5, p. 11; Tr. 248) Mr. Watkins of RMU testified that the negotiations and the different proposals produced a "stack of paper a foot high." (Ex. 5, p. 14) Several topics were discussed in the meetings, including territorial agreements, occupation taxes and street lighting. (Ex. 5, p. 11; Tr. 335) The general manager of IEC acknowledged that these negotiations took place over the period of a year. (Tr. 487) The negotiations took a full year because the parties agreed to an extension of the original 180 day statutory time period in order to continue the original negotiations. (Ex. 5, p. 12)

Early in this case, IEC challenged the validity of the extension of the negotiation period, even though IEC continued to meet with representatives of Rolla after the initial 180 day period had expired. IEC filed a motion to dismiss on December 3, 1999, alleging that there was no request for extension filed with the Commission, and therefore IEC contended that "the extended negotiating period was invalid under the statute."(*See*, Motion, p. 1) Rolla filed a reply to IEC's motion on December 13, 1999, and enclosed a copy of the mutual request bearing the receipt stamp date of the Commission of March 3, 1999. IEC did not challenge the authenticity of such

notice, and the Commission denied IEC's motion to dismiss in an order issued January 18, 2000.

Despite the lengthy negotiations by both parties, no territorial agreement between the parties resulted from the negotiations. (Ex. 5, p. 13) The last day of the 180 day extension for such negotiations was September 3, 1999. (*See*, Appendix A to Rolla's December 13, 1999 "Reply to Intercounty's Response and Intercounty's Motions")

Subsection 6 of § 386.800 RSMo provides that:

> In the event the parties are unable to reach an agreement under subsection 4 of this section [which required the negotiations], within sixty days after the expiration of the time specified for negotiations, the municipally owned electric utility may apply to the commission for an order assigning exclusive service territories within the annexed area and a determination of the fair and reasonable compensation amount to be paid to the affected electric supplier under subjection 5 of this section. ...

Rolla complied with that provision because it filed its application on October 29, 1999, which was within the 60 day period allowed after September 3, 1999.

The application filed by Rolla seeks a Commission order which will transfer the 286 customers from IEC to RMU, and compel the transfer of the IEC electrical distribution facilities within the Southside area. RMU presented a feasibility study which discusses the particulars of the transfers in great detail. (See Schedule RB-3 to Exhibit 4)

4. The 113 Pre-existing IEC Customers

There are some IEC customers who are within the City of Rolla who are <u>not</u> affected by this proceeding. There were several discussions at the hearing in this case about them. What follows is a brief discussion to clarify their situation and distinguish them from those who are the subject of this proceeding.

In a situation which has developed over many years, and in various locations throughout Rolla, there are approximately 113 customers of IEC that continue to be served by IEC even

though they are within the corporate limits of Rolla. (Ex. 5, p. 8; Tr. 370; Ex. 13, p. 3) Those customers were outside the city limits at the time, many years ago, when they needed electric service. RMU was not permitted to serve those customers at the time they needed service precisely because they were outside the city limits. (Ex. 5, p. 8) So IEC served them. Subsequent annexations (but prior to the 1998 annexation which is the basis of this proceeding) have brought those customers within the city limits. (Ex. 5, p. 8) Those 113 customers are not the subject of this proceeding because

a) Rolla has not sought their transfer in this proceeding (Tr. 190), and

b) § 386.800 RSMo does not allow them to be transferred. (Ex. 5, p. 8)

They are not all "stranded" customers in the sense that term has generally been used in this proceeding. (See Tr. 191)

Whether RMU could have acquired those 113 customers in the past was discussed in this case, but it really has no bearing on the issues in the case. There was no evidence as to when the property pertaining to each of those customers was annexed into the city, so there is no way to determine what statutes were in effect and would have applied to those customers at the relevant time. The anti-flip flop statutes have changed several times since being originally enacted in 1982. See, e.g., § 393.106 RSMo 1986 and 1994. This case emanates from the 1998 annexation, which was the first major annexation of its kind in Rolla in over 20 years. (Ex. 4, p. 12) This means there are many possibilities to explain why they are still IEC customers. Those possibilities include

a) the statutory provisions at the time,

b) the customer's lack of knowledge about the possibility of a change,

c) the customer's inertia or lack of desire to make any change, or

d) any number of other unknown reasons (Ex. 7, pp. 37)

Mr. Watkins testified that to his "knowledge, RMU has always been willing and able to serve customers in the city who want service." (Ex. 7, p. 37)

The point of this brief discussion is there is insufficient evidence for the Commission to determine *why* these 113 IEC customers did not change suppliers, or even whether they had an opportunity. Therefore, no conclusions can be drawn whether they had opportunities and consciously rejected them. There is only one appellate court case where the court said an electric customer was free to unilaterally switch to a municipally owned electric system. ***Union Electric Co. v. City of Jackson***, 791 S.W.2d 890 (Mo. App. S.D. 1990). The General Assembly shut that door the next year with the enactment of § 91.025 RSMo in 1991.

The General Assembly was aware of the incongruity created when an annexation changes the legal character of an area from its previously "rural" designation.[4] Prior to 1991, however, when § 386.800 RSMo was enacted, there was no effective statutory procedure for a municipal utility, in conjunction with a municipal annexation, to force the transfer of customers who were being served by another utility. The only statutory provision which attempted to address the situation was ruled to be ineffective by the Missouri Supreme Court in 1966.[5] With the

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[4] "The incongruity is that of a cooperative organized 'for the purpose of supplying electric energy ... in rural areas ... supplying electricity within the corporate limits of a populated city served by a municipal utility or a franchised privately owned utility.' Operation in rural areas is the principal concern of The Rural Electric Cooperative Law." ***Missouri Public Service Company v. Platte-Clay Electric Co-op, Inc.***, 407 S.W.2d 883, 890 (Mo. 1966).

[5] See § 394.080.4 RSMo 1994 which indicates that a cooperative is entitled to continue to serve customers in an area that ceases to be rural due to an annexation until the municipality arranges to "purchase the physical properties of such cooperative located within the boundaries of the municipality, pursuant to law ... ." This provision was interpreted by the Supreme Court as meaning that a reluctant cooperative was not required to sell its facilities. "There is no provision for the enforcement of a sale at the figure fixed by the Commission; no sanction for nonconformance or noncompliance." ***Missouri Public Service Company v. Platte-Clay Electric Co-op, Inc.***, 407 S.W.2d 883, 891 (Mo. 1966).

enactment of a new and separate provision in 1991, and the inclusion of language compelling the transfer of title and operations after the Commission reached a decision, the General Assembly obviously intended to force the transfer of such customers. Therefore, these 113 IEC customers are the legacy of past annexations where, due to the law in effect at the time, the City of Rolla was powerless under Missouri law to force IEC to transfer the customers to RMU.

There does not appear to be anything that any municipal system in the state can do about forcing the transfer of customers served by another supplier due to long-past annexations. (Ex. 5, p. 8) Mr. Bourne of RMU said the City of Rolla is not aware of any statutory provision which could force their transfer now. (Tr. 113) Section 386.800 RSMo does not have any sort of "retroactive" provisions to deal with customers of other systems (either cooperatives or regulated utilities) that have come into a city through a prior annexation. Instead, the provisions relate to a current annexation since the time requirements are tied to "the effective date of the annexation." Annexations from prior years clearly would not qualify for this new process because they could not meet the time frames. (Ex. 5, p. 8) Consequently, IEC can continue to serve those 113 customers that are inside the city limits, but not within the boundaries of the Southside area.

Contrary to the implications of a question from counsel for Southside Neighbors (Tr. 186), the forced transfer[6] of these customers to RMU has never been a question of money and how much RMU would be willing to pay "to attempt to acquire these customers." As the discussion immediately above demonstrates, there was no statutory provision which would allow their *forced* transfer to RMU between 1966 and the filing of this case. As was clearly

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[6] Voluntary transfers are possible under the provisions of the "flip-flop laws" if certain provisions are met and the Commission approves. However, municipal systems were not subject to those laws until July of 1991. See § 91.025 RSMo 1994.

demonstrated at the hearing, IEC it is not interested in voluntarily transferring any of its customers under any circumstances. (Tr. 392)

This does not mean that the situation involving the 113 IEC customers is a "good thing" or an example to follow. The contrary is true. It simply means that the situation exists and there are no statutory provisions which RMU can utilize to force a sale and to remove the duplicate electric lines. There obviously was a decision made by the General Assembly in 1991 to "grandfather" these past situations. Thus, as Mr. Watkins testified, there are duplicate facilities in place serving those 113 customers. (Tr. 371) The presence of the duplicate facilities means both systems bear the uneconomic cost of that duplication. (Tr. 371) The duplication also places higher costs on RMU because RMU has to install additional facilities than otherwise necessary to work around the IEC lines. (Tr. 371) There are also safety concerns about the duplicate systems, but Mr. Watkins testified that "we are aware of" them and "work around" them. (Tr. 371) This is certainly not an ideal situation.

Another troublesome aspect is that the City does not have the ability to obtain the same type of revenue from these 113 customers that it does from the RMU customers. Rolla does not collect any type of franchise fee from the 113 IEC customers. (Tr. 403) Mr. Watkins said "I don't think the City has an avenue to extract it from them." (Tr. 392) As discussed in more detail elsewhere in this brief, there is no statutory provision in place for Rolla to collect a "franchise tax" or "franchise fee" from the electric service IEC provides to them. IEC is not making a payment in lieu of taxes on these customers, either. (Tr. 391) This creates an *inequitable* situation where those customers receive certain city benefits (i.e., police station, recycling center, street lighting) without having to pay for them.

The provisions of § 386.800 RSMo also indicate the General Assembly generally wishes

the transfer to take place; otherwise it would not have mandated certain provisions, such as the amount of compensation to be paid.

5. Argument

In briefing this case, Rolla has attempted to follow, as much as practical, the list of issues submitted by the parties, but has included issues which were directed by the Regulatory Law Judge to be briefed.

6. Public Interest

The following sections will focus on the "public interest" aspects of the proposed transfer of facilities, although "public interest" is not the exclusive topic under this heading. Neither is the topic of "public interest" necessarily confined to items under this general heading. For purposes of this case, RMU considers "the public" to encompass significantly more interests than those of just the 286 IEC customers in the Southside area.

7. Effect if Commission Denies Transfer

The most obvious effect if the Commission denies RMU's application will be an unnecessary proliferation of overhead electric lines in the Southside area, primarily in four residential subdivisions. (Tr. 184). This will result from IEC being allowed to continue to serve the 286 customers it is now serving, but RMU will be building new lines into the area to serve new structures erected since the annexation. The legal reasons for this are explained elsewhere in this brief.

This dual or duplicate system of electric distribution in the area will, in turn, have additional consequences which are less obvious than the aesthetic characteristics of a 40 foot utility pole with cross-arms in a customer's front yard. These less-obvious consequences

include:

- Approximately 35,600 electric customers of RMU and IEC having to pay for the unnecessary costs of each to construct and maintain the two systems in the Southside area. (Tr. 211; Ex. 5, p. 15)

- All of the members of the public being exposed to greater risk of injury from colliding with utility poles in the Southside area. (Tr. 212)

- All of the members of the public being exposed to a greater risk of serious injury or even death from contacting overhead electric lines. (Tr. 212)

- All of the line workers of IEC and RMU will be exposed to a greater risk of serious injury or death from work-related incidents in the Southside area, because there will be greater congestion of lines. (Tr. 204)

- The inequity of 286 IEC customers being able to take advantage of the same city services and facilities as customers of RMU, but not having to pay for those benefits. (Tr. 368) The 113 customers of IEC in the city now are an example of the inequity that the General Assembly was trying to remedy in § 386.800 RSMo. They get benefits of city services but don't pay their share because IEC doesn't make any franchise payments or provide any services similar to those of RMU, such as street lighting.

- A frustration of the clear and obvious intent of the General Assembly to allow municipal utilities to expand their service areas and spread fixed costs over more units, to the benefit of their customers.

8. Impact of Transfer on RMU

Adding 286 customers to RMU's current base of 7,800 electric customers is an increase

of about three and seven tenths (3.7) percent. RMU does not foresee any changes to its operations, rates, or quality of service related to this relatively small addition of customers and facilities. IEC presented no evidence that there would be any negative impact on RMU's customers as a result of this transfer.

The witness for the Southside Neighbors implied that the transfer would cause RMU to raise electric rates. (Ex. 12, p. 7) Mr. Watkins strongly refuted that, saying "there is no rate increase for RMU's customers planned and none even visible on the horizon." (Ex. 7, p. 16) His testimony was supported by that of RMU's independent auditors. (Ex. 1, pp. 3-4)

9. Impact of Transfer on IEC

There will be no negative impact on IEC if the Commission grants RMU's application because the transfer of these 286 customers and associated facilities will have no lasting effect on IEC. It will be fully and fairly compensated for any expenditures it has related to the transfer.

The transfer of the 286 customers will hardly be felt. (Ex. 7, p. 23) First, IEC is a much larger enterprise than RMU. IEC serves portions of nine counties in Missouri, has 28,700 members, and has $27,000,000 in gross annual revenues. (Tr. 506) Therefore, the transfer of 286 customers out of 28,700 represents a loss of only one (1) percent. (Ex. 5, p. 17)

Second, IEC's recent historical growth pattern demonstrates that IEC will *regain* that amount of customers in just a few months. IEC has added an average of 718 new customers per year over the last five years. (Ex. 5, p. 17) That means IEC averages 59.8 new customers per month. At that rate, the loss of 286 customers to RMU will be more than made up in customer growth on IEC's system in less than five (5) months. After a year, it will hardly be noticed.

IEC also will be fully compensated for the value of its facilities if the Commission orders

the transfer. Pursuant to the statute, IEC would be paid **a)** the amount the Commission determines is appropriate under the "reproduction cost new less depreciation on a straight line basis" calculation for its facilities, **b)** it would be fully compensated for the re-integration and new construction of its facilities both inside and outside of the Rolla city limits, and **c)** it will receive in a lump sum, *four times* the annual revenue it received from the customers being transferred. (Ex. 5, p. 17) · Significantly, the four times annual revenue is a "gross" number; not a "net" number. This means IEC is not just receiving four times the "profit" it made on those customers for a year. It will receive four times the *entire amount billed* those customers during the year, which includes the cost of the power and service provided.

Let's briefly examine the impact of a payment of four times gross revenues to put this into perspective. Let's assume -- for discussion purposes only -- that a total compensation amount of $1,500,000 is determined by the Commission in this case. That translates to a "per customer" price of $5,245 ($1,500,000/ 286 = $5,244.75). That is a very rich price. A recent arm's length utility asset sale approved by the Commission did not even approach that sort of price tag on a per customer basis.[7]

For a further "per-customer" comparison, let's look at the recent $190,000,000 merger between UtiliCorp United Inc. (UCU) and St. Joseph Light & Power Company (SJLP).[8] The publicly announced figures demonstrate that UCU acquired the 66,000 electric customers of SJLP for approximately $2,879 per customer. ($190,000,000 / 66,000 = 2,878.78). That is about

[7] The 5,000 customer West Elm Place Corporation sewer system sale to a public sewer district was approved in 1999. See Case No. SM-99-193, Report and Order issued April 22, 1999. The purchase price was deemed highly confidential but was less than $5,000 per customer.

[8] Approved by the Commission in Case No. EM-2000-292.

half the cost on a per-customer basis if the Commission determined a total $1,500,000 price tag in this case.

There is another way to compare the UCU/SJLP case and this case. If *only* the 400 % of gross revenue calculation (applicable only to this case) were applied to the UCU/SJLP merger, UCU would have had to pay $412,000,000 to obtain the $103,000,000 in annual revenues of SJLP's customers instead of the $190,000,000 actual figure contained in press releases. This clearly shows the statutory amount of 400 % of gross revenues, in and of itself, is more than a very fair price compared to recent arm's length transactions. *The 400% figure doesn't even include the payment for the IEC facilities at reproduction cost new less straight line depreciation.*

Continuing with another example, if the assumed total compensation to IEC in this case is $2,000,000, the per customer price becomes $6,993. If we further escalate the total to $4,000,000, to bring it closer to IEC's asking price, that raises the per customer price to an astonishing $13,986. That amount is more than four times (actually 4.755 times) the price UCU paid for SJLP on a per customer basis. No rational person can argue that IEC is not being fairly compensated with the 400 % calculation, based on recent objective standards as measured in the marketplace. Mr. Watkins said that payment is roughly equal to the margin (profit) a regulated utility would receive over a period of 35 to 40 years in serving such customers. (Ex. 7, p. 32)

Mr. Ketter of the Staff agreed that the "transfer of approximately 286 customers to the City" would have "little impact on the revenue or electric load" of IEC. (Ex. 13, p. 16)

Therefore, it is clear that the impact of this transaction on IEC is temporary and minimal and IEC will be more than fairly compensated for the transfer. The loss of customers is only about one percent on a customer and load basis, and will be absorbed many times over by

customer growth. The 400 percent of gross revenues payment to IEC is quite rich by recent objective market standards, so IEC could be said to benefit from a financial standpoint from the transaction. In addition, any temporary loss of load on IEC's facilities will be quickly made up for in load growth, based on historical patterns.

10. Impact of Transfer on IEC's Customers in the Area

There will only be a brief and temporary interruption of service to accomplish the physical transfer of customers from IEC's system to RMU's system. (Ex. 5, p. 22) After that, the 286 customers should enjoy the same (and probably better) level of service. **They will also see an immediate reduction in their electric rates of twenty five (25) percent!** (Tr. 371)

The immediate rate benefit to the customers should neither be overlooked or diminished when the Commission considers the "public interest" aspects of this situation. Mr. Watkins testified that RMU

> can provide an immediate savings to the residential customers. RMU's rates for electric service are approximately twenty five (25%) cheaper than Intercounty's. Assuming 1,000 kwh per month for a typical residential bill, Intercounty would charge $75.50 for that usage, and RMU would charge $60.00. Transferring those customers to RMU would therefore amount to an annual savings of $186.00 for a typical residential customer in the Southside Annexation. (Ex. 5, p. 15)

This rate comparison was verified by other comparisons performed by the Staff. (Ex.13, p. 15)

Although Mr. Priest for the Southside Neighbors and Mr. Strickland for IEC both argued that RMU would be increasing its rates in the future, there was no evidence to support either of their unsubstantiated claims. Mr. Watkins testified in no uncertain terms that "Given RMU's financial status, there is no rate increase for RMU's customers planned and none even visible on the horizon." (Ex. 7, p. 16) He testified that even if RMU were ordered to pay the full amount requested by IEC, it still would not trigger a rate increase. (Ex. 7, p. 47) RMU even offered the

testimony from a Certified Public Accountant from its outside accounting firm to provide an objective viewpoint. Mr. Marmouget testified that given the level of RMU's reserves, he could not envision a rate increase for RMU if RMU were required to pay a fair amount for the IEC facilities. (Ex. 1, p. 4)

Mr. Watkins also testified there would be no deterioration in the quality of electric service these 286 customers receive. (Ex. 5, p. 16) He explained that RMU has been providing dependable electric service for 55 years. With crews located right inside the city, he said it could rapidly respond to any emergency. (Id.) Mr. Watkins and Mr. Bourne both testified those crews can be anywhere in Rolla in ten minutes or less from the RMU service center. (Ex. 7, p. 11; Tr. 190) Mr. Watkins said RMU has mutual assistance pacts with other utilities to bring in additional workforce in the case of something like a major ice storm. (Ex. 5, p. 16)

Mr. Watkins presented the results of a citizens' attitude study done by the City of Rolla in 1975, 1981, 1988, and 1994. With regard to the electric department (RMU), the results showed an increasing and positive attitude rating in all the survey years. The 1994 survey showed that 93 percent of the Rolla citizens approved of the city's electric department, with only a 3 percent disapproval. (Ex. 7, pp. 12-13)

Although the spokesman for the Southside Neighbors made unsubstantiated allegations about anticipated poor service after the transfer, there was no objective evidence presented that RMU's service is inferior in quality to IEC's. Mr. Priest made the absurd claim that RMU would discriminate against residents in the Southside Annexation area by not providing the same prompt response to an outage that it would somewhere else in the city. (Ex. 12, p. 8) The nature of that claim brings into serious question the credibility of that witness. Mr. Watkins testified that the prioritization for restoration of electric service in the event of outage has nothing to do

with when a particular area was annexed. (Ex. 7, pp. 8-9) It is based on safety, restoring emergency services and communications, and then on the system generally. (Ex. 7, pp. 8-9)

Mr. Watkins testified, as a customer of IEC, that he recently experienced *daily* outages on IEC's system at his home. (Tr. 414) Of course, RMU also has minor outages from time to time due to un-preventable situations. (Tr. 414) The only two major (i.e., city-wide) outages in Rolla in the last three years were caused by tornadoes striking the AmerenUE transmission system. (Tr. 413) The Southside Neighbors cannot rationally blame those events on RMU management, and on that basis claim they will receive poor service in the future as customers of RMU. In fact, IEC had facilities that were damaged by the second of those tornadoes and some of their customers were without service for several days. (Ex. 7, p. 10) RMU's system is as reliable as IEC's, and perhaps more so. (Ex. 7, pp. 10-11) RMU has more equipment and manpower per mile of line than IEC. (Ex. 7, p. 11)

There are two other objective voices on the issue of reliability and service. The Office of the Public Counsel indicated that it believed RMU was capable of providing safe and reliable service. (Tr. 65) Mr. Ketter of the Staff examined the RMU system and testified that it could serve the new customers in the Southside area. (Ex. 13, p. 16) Of perhaps even greater significance is the fact that Mr. Ketter, an electrical engineer who has objectively studied the situation, did *not* testify about any problems RMU would have serving those customers.

11. RMU's New Power Agreement

RMU's new wholesale electric supplier agreement will not have an adverse effect on customer rates or on service reliability. Although IEC tried to argue that rates for service in Rolla would be going up somehow, there is no evidence to support this allegation.

RMU did change wholesale suppliers recently. It changed from being a full-requirements customer of AmerenUE to being a full-requirements contract customer of the Missouri Public Energy Pool on December 31, 2000, at midnight. (Tr. 253) An "all-requirements" contract means that the supplier provides all the power the RMU system requires. (Tr. 203) AmerenUE is still a part of the overall picture because the power will continue to be delivered over the AmerenUE transmission system, just as it has for 50 years. (Tr. 252) That transmission service arrangement is subject to a tariff and the jurisdiction of the Federal Energy Regulatory Commission. (Tr. 387, 412)

Mr. Watkins testified there is "no question that we have the means to provide service to these new customers."(Ex. 7, p. 46) He also testified there will be "no effect on the Southside annexation customers' rates." (Tr. 387) He characterized the new situation under the pooling arrangement as "a wash" between the previous wholesale costs and the new costs. (Tr. 232) In other words, he said, "if there is no real difference in the net wholesale power supply costs," then retail rates would not change. (Tr. 232-233) This was confirmed by the outside auditor. (Tr. 125-126)

Essentially, then, the evidence is that while the supplier of the power itself changed with the new year, neither the rates nor the reliability changed. Therefore, the change in power supplier does not prove that the transfer of the 286 customers is detrimental to the public interest. The evidence is that they would experience the same rate structure being charged the other RMU customers, which is 25 percent lower than the rates IEC charges.

12. Trailer-Mounted Generation

Contrary to the assertions[9] of IEC, RMU's recent lease/purchase of some trailer mounted generation equipment will have no adverse effect on its customers' rates or service reliability. IEC injected this topic as an issue in this case but it essentially was a red herring. There is no evidence to support any of its allegations about the acquisition of this generation requiring rate increases to RMU customers.

Mr. Watkins testified that the implementation or use of these additional generation resources will not cause any change in RMU's rates. (Tr. 407-408) They are being leased. (Ex. 7, p. 46) Mr. Watkins explained that "with a lease, we can stop making payments, return the equipment, and walk away without incurring long term debt." (Ex. 7, p. 46-47)

More importantly, whether RMU fully implements and utilizes the leased generation has no bearing on whether it can provide adequate service to the 286 new customers that are the subject of this proceeding. Because RMU has an all-requirements contract with the Missouri Public Energy Pool, as explained in the immediately preceding topic, what RMU does with this trailer-mounted generation has no effect on that contract. (Ex. 7, p. 47)

13. Franchise/Occupation Tax or PILOT

This section of this brief and the following one concerning the Annexation Plan of Intent, are related. It is apparent that IEC's original position on the payment of a franchise fee or tax led to the City saying in one of the versions of the Plan of Intent that IEC would continue to serve the 286 customers. It is also apparent that IEC's change of position after the annexation, and the

[9] Mr. Strickland alleged that RMU was taking on a $6,000,000 debt load. (Ex. 11, p. 20) This was shown to be false. (Ex. 7, p. 46)

inability of the parties to negotiate a territorial agreement or any sort of payment in lieu of tax (PILOT), ultimately led to the City filing this case. IEC and the Southside Neighbors place great emphasis on what was said in the Plan of Intent. The Commission, however, needs to understand why it was said at the time, and why things changed. To fully understand that requires an explanation of the issue of taxes or payments in lieu of taxes.

Franchise, License or Occupation Taxes

We have to start with the premise that as a statutory class city, Rolla does not have any authority to impose taxes or fees on anyone unless it is authorized by statute. Section 71.610 RSMo says that

> No municipal corporation in this state shall have the power to impose a license tax upon any business, avocation, pursuit or calling, unless such business, avocation, pursuit or calling is specially named as taxable in the charter of such municipal corporation, or unless such power be conferred by statute.

This section and ordinances imposing licenses and business taxes in Missouri statutes are required to be construed liberally in favor of the citizen sought to be taxed and strictly against the authority attempting to tax. ***City of Odessa v. Borgic***, 456 S.W. 2d 611 (Mo. App. 1970). Any reasonable doubt as to whether a power has been delegated to a city is resolved in favor of non-delegation. ***Anderson v. City of Olivette***, 518 S.W.2d 34 (Mo. 1975). In other words, if a statute or a city charter does not clearly and explicitly give the power to tax to a city, it does not have the power. Since Rolla is not a charter city, we must examine the statutes applicable to cities of the third class to determine its specific taxing authority.

Section 94.110 RSMo provides for a license tax to be levied by cities of the third class upon certain specific businesses. While "light, power and water companies" and "gas companies"are specifically listed, there is no specific listing for "rural electric cooperatives."

Under the holding in ***Odessa*** and ***Olivette***, *supra*, it therefore appears the General Assembly does not intend for cities of the third class to be able to impose a license or occupation tax on rural electric cooperatives in the same fashion the city can on regulated gas and electric companies.[10]

Franchise Fees

There is nothing in either § 71.520 or § 88.613 RSMo which specifically authorizes a city of the third class to extract a "fee" for granting a utility franchise to anyone. Neither is there any Missouri statute which authorizes a "franchise fee" in the context of grants of franchises by municipalities to utility companies.

PILOTS

A recently enacted statutory provision says, in a section explicitly noted as conveying the *intent* of the General Assembly, that "Political subdivisions impose license taxes, franchise fees and sales taxes on providers of electricity and gas services and *require payments in lieu of taxes from publicly owned utilities* ... ." § 393.297.2 RSMo Supp. 1999. Note that this provision is *not* a grant of authority to any city to do anything. It is merely a recitation of an understanding of the General Assembly. In § 393.298(7) RSMo Supp. 1999, the General Assembly defined the

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[10] This conclusion is supported by the ruling in ***Petrolene, Inc. v. City of Arnold***, 515 S.W.2d 551 (Mo. 1974). In that case, the Supreme Court ruled that a liquefied petroleum gas ("LPG") dealer was not a "gas company" under the statute because LPG was delivered in a liquid state rather than a gaseous state. The Court also relied on the fact that the Commission regulates "gas companies"as public utilities but not LPG dealers, while pointing out that LP Gas had a chapter of the statutes of its own. "Thus it is the policy of this State to separately provide for registration and regulation of those dealing with LPG by a different agency from those dealing with gas." ***Id.*** at 553. This demonstrates that the Supreme Court construes this statute very strictly against cities. While "light and power companies" are extensively regulated by the Commission, rural electric cooperatives are not. Cooperatives have their own chapter in the statutes (Chapter 394) which is separate from those of Commission-regulated companies in Chapters 386 and 393). Thus, under the rationale in ***Petrolene, Inc.*** and similar cases, it is likely that a court would rule that since cooperatives are not specifically listed in § 94.110 RSMo, and are distinct from "light, heat and power companies" because they are "cooperatives," they are not taxable under that section.

term "payment in lieu of tax"or PILOT as follows:

> "PILOT," the payment or transfer of funds or services by a gas or electric utility owned by a political subdivision and used to provide government services by the political subdivision including the value of free or subsidized services, provided the value of these services are stated annually in an ordinance as a percentage of the total gross receipts of the gas or electric system.

There is also a provision in § 393.298(9) RSMo Supp. 1999 which discusses a PILOT in the sense that it is "for the corresponding use of rights-of-way, utility easements or the distribution system of a political subdivision." There are references to PILOTs in other sections of the statutes that have nothing whatsoever to do with utilities, most notably in tax increment financing provisions in Chapter 99 RSMo. A PILOT has been discussed in a reported case.[11]

City of Rolla / IEC

The previous discussion demonstrates that Rolla does not have the statutory authority to pass an ordinance levying a license or occupation tax on IEC as it would with an electric company, or as it has with a gas company. It is also clear that Rolla does not have any explicit statutory authority to levy a "franchise fee." The municipal electric and water operations (RMU)

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[11] A PILOT was the subject of ***Pace v. City of Hannibal***, 680 S.W.2d 944 (Mo. banc 1984). The municipally-owned electric utility in Hannibal, a special charter city, had provided for payments in lieu of taxes (at 5 ½ percent) from its municipal utility to the general revenue fund of the city since the inception of the utility operations. The court said it had not been shown any provision in the charter, statutes or ordinances which mandated any such payments by the board of public works, and therefore concluded the payments were voluntary, and the board could reduce or eliminate them if so disposed. ***Id.*** at 945. The court ruled that the PILOT was not a "tax, license or fee" under the provisions of the Hancock Amendment because it was not a fee in and of itself and it was not imposed by statute, charter or ordinance. It noted that because the 5 ½ percent factor was applied to the increased revenues resulting from the rate increase, it did not amount to a "tax, license or fee." There also was a footnote (***Id.*** at 945) which says that many publicly-owned utilities do transfer some revenue to taxing bodies in what are called payments in lieu of taxes, quoting from a 1983 article in *Public Utilities Fortnightly*. The court said that it was "fairly inferable" that the PILOT made by the board was designed to compensate the city for "inconvenience and expense attending the use of public property." "Were it not for the payments in lieu of franchise tax it would be appropriate for the city to levy a charge against the Board of Public Utilities for the fair value of the use of public property, including provision for maintenance and repair on account of wear, tear and damage attributable to the utility." ***Id.*** at 948.

do make a PILOT to the City of Rolla. (Ex. 5, p. 13)

Mr. Watkins testified that the City's intention, prior to the annexation in 1998, was clearly that the 286 customers in the Southside area would remain the customers of IEC. (Ex. 6, p. 2; Tr. 267) He said there was no intention prior to annexation election to make a § 386.800 RSMo filing such as this one. (Tr. 240) This explains why the Plan of Intent was written the way it was. He said the City's intent at that time was based on the understanding that he and other city officials had since about 1992 that IEC would make a PILOT and provide services to the City comparable to those being provided to the City by RMU. (Ex. 6, p. 2; Tr. 239) This understanding on the part of the City was corroborated and bolstered by language in previous drafts of territorial agreements (such as one in 1994) that IEC had provided to the City. The 1994 draft from IEC said "Intercounty agrees that Rolla may establish a franchise fee or tax uniformly applied throughout the city for energy sales within the corporate limits of the City of Rolla." (Tr.496-497)

Thus, the City believed that it would receive a PILOT from IEC or something comparable to what RMU was paying the City. With such a revenue source, the City did not have a great incentive to attempt to purchase the facilities and customers. Mr. Watkins said that the City was willing to let IEC continue to operate inside the City if there was a "level playing field." (Tr. 367) A "level playing field" for these purposes meant IEC making a PILOT and providing free street and signal lighting as RMU was doing. (Tr. 367)

Mr. Watkins testified that between the date of the annexation election (April 7, 1998) and the effective date of the annexation (June 6, 1998) "IEC made it clear to the City that they had no intention of doing that." (Ex. 6, p. 2; Tr. 269) This message was delivered by an IEC employee, Mr. Cartwright. (Tr. 272, 314, 327) Mr. Watkins testified that at that point, the City decided to

pursue relief under § 386.800 RSMo.

During the mandatory negotiations on a territorial agreement under § 386.800 RSMo there were further discussions about franchise taxes and PILOTS. Mr. Watkins said he was not sure when the franchise tax problem was first identified, but it really was nullified by the fact that IEC refused to agree to a PILOT. (Tr. 406) IEC specifically declined to make a PILOT to the City in the § 386.800 RSMo negotiations during 1999. (Tr. 407) This corroborates Mr. Watkins' testimony that that was the message he received between April and June of 1998 from Mr. Cartwright of IEC. It was also corroborated by Mr. Strickland's testimony at the hearing:

> At the meeting [the City and RMU] were told there was no way [IEC] could discuss a PILOT. They were told no way twice that we would discuss it, and we did not discuss a PILOT. (Tr. 499)

IEC's position on taxes thus effectively put the City of Rolla into the proverbial "trick box." IEC had put it in writing in the early 1990's that it would agree to a franchise or utility tax (Tr. 499) but Rolla subsequently discovered that it didn't have statutory authority to impose such a tax. Rolla then asked IEC to make a voluntary PILOT, as RMU does, and was told "no way twice" by IEC.

As a voluntary payment, it is clear that IEC could have agreed to a PILOT if it had wanted to. (Tr. 406) Its prior written representations in draft territorial agreements had clearly indicated it would be willing to make the same type of payments that RMU was making, so there is no legitimate reason that IEC could not have agreed to make the PILOT on the same basis. Mr. Strickland candidly admitted at the hearing that he knew that a territorial agreement "wouldn't go anywhere without the possibility of a franchise tax." (Tr. 513) Since RMU could not lawfully impose a tax on IEC, and IEC flatly refused to voluntarily make a PILOT as a substitute, it is no wonder that the territorial negotiations did not produce an agreement.

14. Annexation Plan of Intent

As noted in the immediately preceding section, the Plan of Intent and the issue of franchise taxes or payments in lieu of tax (PILOT) are inextricably intertwined in this case.

IEC and the Southside Neighbors want to place great emphasis on the text of the Plan of Intent, and will likely argue that Rolla is somehow bound by that language. As the discussion in this and the preceding section demonstrates, it was IEC's refusal to agree to a PILOT, or otherwise create a "level playing field" in the Southside area, that caused the City to file this case.

What Is A "Plan of Intent?"

A plan of intent is something required by state statute as a part of the municipal annexation process. The plan of intent required by § 71.015 RSMo, however, is not intended to bind a city indefinitely to a certain method. "The procedure outlined in the statute does not require a city to formally adopt the Plan of Intent. Instead, the city must present the Plan and evidence in support of it at the public hearing on the ordinance." ***City of Lake Winnebago v. Gosewisch***, 932 S.W.2d 840, 844 (Mo.App. W.D. 1996). The statute "only requires a listing of services currently provided in the city which the city plans to provide in the annexed area." ***Id.***

The "plan of intent" is required to include: **a)** a list of major services presently provided by the city; **b)** a proposed time schedule to provide such services to the annexed residents, not to exceed three years from the effective date of annexation; **c)** tax rate of annexed property; **d)** potential zoning of the property; and **e)** effective date of annexation. § 71.015.1(4). The statute never requires the plan of intent to explain *how* the services will be provided, and therefore, it can be argued that such language in a plan of intent is superfluous. Of course, the city is required

to present evidence in conjunction with the plan of intent at the public hearing, but this evidence is not mentioned as binding on the city. As ***Lake Winnebago*** states, the city does not formally adopt the plan of intent. It is merely used for the public hearing.

In summary, the annexation statute *does not* state that the city must provide service as dictated by the evidence supporting its plan of intent; merely that services must be provided within three years. There is no requirement as to how the services are provided. The plan of intent does not need to include "how" the services are provided, therefore, that section cannot mean anything other than the services must be provided in the three year window. (RMU is already providing electric service in the Southside area. (Tr. 198))

There is further proof that a city need not formally adopt, and thereby be bound by, its plan of intent. In ***City of Rolla v. Armaly***, 985 S.W.2d 419 (Mo.App. S.D. 1999), the city altered its plan of intent after the public hearing. The court stated that the statutes do not prohibit a city from altering its plan of intent or ordinance once a declaratory judgment action has been initiated. However, the plan must be settled before the trial court can grant the declaratory judgment approving annexation. IEC or the Southside Neighbors may argue that Rolla has deviated from the plan approved by the trial court by filing this case, when the Plan indicated continued service by IEC. In ***Armaly***, the part of the plan in question dealt with water supply. The plan set out the estimated costs to the city and the annexed residents of installing sewer and water services. The plan also listed the cash and reserves available to fund the installation. The court held that the city presented the financial wherewithal to provide the service, and that is all the statute requires. The *method* of providing the services was not discussed by the court. The pertinent statute reads:

The petition in such [declaratory judgment] action shall state facts showing:

* * *

(c) The ability of the city . . . to furnish normal municipal services of the city . . . to the unincorporated area within a reasonable time not to exceed three years after the annexation is to become effective.

Section 71.015.1(5). Again, there is nothing about method, only ability. Certainly, the identity of the electric service provider is not a material deviation, in any event.

Additionally, the city council that adopted the plan of intent containing language about service by IEC cannot legally bind future city councils with language in a plan of intent. Practically speaking, members of a city council are but trustees of the public -- they can not pass an irrevocable ordinance when acting in the exercise of legislative discretion. No city council "could bind itself or its successor to make or continue any legislative act." ***City of Springfield v. Clouse***, 356 Mo. 1239, 206 S.W.2d 539, 545 (Mo. banc 1947). Therefore, a new city council can certainly alter a current ordinance if it wishes.

The Southside Neighbors and IEC both appear to be arguing that the city should be prevented (what the law calls "estopped") from deviating from what was said in the plan of intent about electric service to the 286 customers. The doctrine of estoppel "applies, not only to natural persons and private corporations, but to municipalities as well, and that [is true] even though such municipalities are acting in a 'governmental capacity'." ***Twiehaus v. City of Wright City***, 412 S.W.2d 450, 452 (Mo. 1967). However, "as to municipalities it is applied cautiously because of the public interest involved." ***Coalition to Preserve Education on Westside v. School Dist.***, 649 S.W.2d 533, 553 (Mo.App. W.D. 1983).

In order to prove that a municipality must be estopped in a particular situation, the residents must show: 1) a statement or act by the government entity with the subsequent governmental act; 2) the citizen relied on the act; and 3) injury to the citizen. In addition, the

governmental conduct complained of must amount to *affirmative misconduct*. ***Missouri Gas Energy v. Public Service Comm'n***, 978 S.W.2d 434, 439 (Mo.App. W.D. 1998), *quoting* ***Coastal Mart, Inc. v. Dept. of Natural Resources***, 933 S.W.2d 947, 956 n.5 (Mo.App. W.D. 1996). The Southside Neighbors could show the first factor. Then they would have to show they relied on the governmental act (i.e., the statement in the plan of intent). Presumably they would do this by showing they voted for annexation in strict reliance on that particular wording in the plan of intent.

First, showing how an individual voted would be almost impossible to prove since it is a secret ballot. Second, the individual would have to show that the reason they voted that way was because IEC was going to continue providing electric service. Simply showing how they voted would not be enough. Third, the resident would have to show *injury*. Given that electricity is a fungible service, and the rates of RMU are 25% lower than IEC's, it would be impossible to prove that an injury has occurred because a different (but equally qualified) entity is providing electricity. Given that the residents would have a difficult time proving factors two and three of an estoppel case, that estoppel is to be applied very cautiously to a municipality or governmental unit, and the governmental act must amount to "affirmative misconduct" the estoppel argument would almost definitely fail, as it did in ***Missouri Gas Energy v. Public Service Comm'n***, 978 S.W.2d 434, 439 (Mo.App. W.D. 1998). It would be impossible to show that Rolla committed affirmative misconduct by pursing a remedy that is clearly provided in a statute that has been in existence for ten years. Everyone is presumed to know what the law is, so neither IEC nor the Southside Neighbors can claim they were unaware of the existence of § 386.800 RSMo.

15. Area To Be Assigned to RMU

16. Commission Lacks Authority to "Assign" Areas to IEC

The Regulatory Law Judge (Tr. 73) posed the question: "Does the Commission have the statutory authority to assign any part or all of the annexed area as the exclusive service area of IEC and, if so, would IEC be able to serve new structures in such an "exclusive" area?" The answers are "no" and "no."

As discussed in more detail below, § 386.800 RSMo gives the Commission authority to establish an exclusive service territory or territories for the municipal utility. It does not give the Commission authority to assign a new and exclusive service area to a rural electric cooperative or an investor-owned utility. It does give the Commission the ability to *refuse* to assign exclusive service areas to RMU. If the Commission does that, by default and the operation of other statutes, IEC would continue to serve the 286 customers -- but no new customers at new structures. That is because IEC's operations within Rolla are within a "non-rural area" and as discussed below, IEC is expressly prohibited from serving any new structures inside Rolla.

No Authority to Assign an Exclusive Territory To IEC

The Commission's authority under § 386.800 RSMo cannot be considered in a vacuum. It has to be considered in the context of other statutes governing the rights of electrical suppliers. All of the acts bearing on the subject must be read so that § 386.800 does not repeal any of the other provisions by implication. ***Bartley v. Special School District of St. Louis County***, 649 S.W.2d 864, 867 (Mo. banc 1983). All consistent statutes relating to the same subject are construed together as though constituting one act, whether adopted as different dates or separated by long or short intervals. ***State ex rel. Rothermich v. Gallagher***, 816 S.W.2d 194 (Mo. banc

1991). Considering the entire legislative scheme and the plain meaning of the language used, the Court must attempt to harmonize each statutory enactment. ***AG Processing, Inc. v. South St. Joseph Indus. Sewer Dist.***, 937 S.W.2d 319, 324 (Mo.App. 1996).

The Commission's ability to assign an exclusive service area (as opposed to approving them as a part of a territorial agreement) is a recent power granted by the General Assembly pursuant to § 386.800 RSMo. A "municipally owned electric utility" is the only type of entity authorized to make the application. § 386.800.6 RSMo. The statutory language is: "... the municipally owned electric utility may apply to the commission for an order assigning exclusive service territories within the annexed area ... ." The statute does not authorize a rural electric cooperative, or a joint municipal utility commission, or an electrical corporation, to seek an exclusive service territory. Given that *only* a municipally owned utility may make such an application, it does not make sense that a non-applicant (such as a cooperative or an electrical corporation) could end up with an exclusive service territory for which *only* the applicant may apply.[12]

To fully understand this issue, we should begin with a general discussion of the territorial rights of municipally owned electric utilities, and in particular, the one owned by the City of Rolla, a city of the third class. Cities of the third class are authorized to provide electric service to their citizens through a board of public works. § 91.450 RSMo. The board is appointed by the

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[12] The statute also says that "applications shall be made and notice of such filing shall be given to all affected parties pursuant to the rules and regulations of the commission governing applications for certificates of public convenience and necessity." § 386.800.6 RSMo. In commission practice, when a public utility or an entity seeking to become a public utility files an application for a certificate of public convenience and necessity, it does not result in some *other* party (who is not the applicant) receiving a certificate for a service area.

mayor and confirmed by the city council. (Id.)

Cities are generally prohibited from serving electricity at retail outside of their corporate boundaries, but there are several important exceptions. § 386.800.1 RSMo. One exception is if "the service is provided pursuant to lawful municipal annexation and subject to the provisions of this section." § 386.800.1(3) RSMo. There are two different ways in which a municipally owned utility can provide service "pursuant to lawful municipal annexation and subject to the provisions of this section." One is if the service is to a *new* structure in the newly annexed area and the other is if the service is to a structure which is already being served by someone else. Subsection 2 of § 386.800 RSMo provides as follows:

> 2. Any municipally owned electric utility may extend, pursuant to lawful annexation, its service territory to include any structure located within a newly annexed area which has not received permanent service from another supplier within ninety days prior to the effective date of the annexation.

This makes clear that the municipally owned utility may *unilaterally* extend its service territory into the annexed area to serve new structures (i.e., those not served by another supplier within the 90 days prior to the annexation) without any further requirements. Thus, a city does not have to receive the Commission's permission to serve *new* structures in the annexed area. This corresponds to the discussion elsewhere in this brief that IEC cannot lawfully serve new customers inside Rolla. This provision legislatively recognizes that the municipal utility is entitled to serve all of the *new* structures in the annexed area.

If the municipal utility wants to serve a structure *already* being served by another supplier, however, it either has to obtain that right through a voluntary territorial agreement, or through the mandatory provisions of § 386.800 RSMo. This is commensurate with other statutes which prevent one supplier from taking over the service being supplied by another supplier. See

§91.025, §393.106 and §394.315 RSMo.

Returning then to whether the Commission can assign an exclusive service territory to IEC, it is clear that § 386.800 RSMo fails to make any express grant of such authority to the Commission. It is the municipal utility that is given the right to seek the exclusive area. No other entity is given that authority.

No Authority to Allow IEC to Serve New Structures Inside Rolla

IEC has no authority to serve new structures inside Rolla, it has not claimed any right to do so in this case, and the Commission cannot grant that right to IEC. Nevertheless, the Commission appears interested in that possibility.

Rural electric cooperatives cannot lawfully serve new structures inside cities greater than 1,500 in population. That has been the law in this state for decades, and was not changed by § 386.800 RSMo. See, ***Missouri Public Service Company v. Platte-Clay Electric Cooperative, Inc.***, 407 S.W.2d 883 (Mo. 1966) (***"MoPub I"***); ***Farmers' Electric Cooperative v. Missouri Dept. of Corrections***, 977 S.W.2d 266 (Mo. banc 1998). Nothing in § 386.800 RSMo 1994 indicates any legislative intent to overrule previous Supreme Court precedent to grant a new power to the Commission which conflicts with other statutes and case law.

The law is clear, from multiple decisions of appellate courts, that a rural electric cooperative such as IEC does not have the right to serve new structures with electricity when those structures are built on land which has been annexed into a city of more than 1,500 in population, and thus ceases to be a "rural area." Rolla has a population substantially greater than 1,500, so it is a non-rural area. (Ex. 5, p. 7) In 1966, the Supreme Court held in ***MoPub I***, 407 S.W.2d at 894 that:

The primary purpose of Chapter 394 [governing rural electric cooperatives] is to bring

> electric service to members of the cooperative living in rural areas not otherwise served. Section 394.080(4) allows an exception due to changed conditions, but this exception is not to be extended by implication because it runs counter to the spirit and purpose of the chapter as a whole, which does not contemplate the expansion of the cooperative's facilities or the addition of new members or new customers in annexed areas. Accordingly, the cooperative cannot extend service to the owners of homes and businesses built after annexation on lots purchased from pre-annexation members who have subdivided their original land holdings. The franchised [or municipal] utility is entitled to supply this kind of new demand for electric energy in the annexed areas and in view of the cooperative's announced intentions is entitled to be protected against this type of competition by injunctive relief.

In a more recent decision, ***Farmers' Electric Coop. v. Missouri Dept. of Corrections***, 977 S.W.2d 266 (Mo. banc 1998), the Supreme Court held that a cooperative was not entitled to supply electric service to a new prison facility within the city limits of Cameron, Missouri, when construction of the prison did not commence until after annexation.[13] It held that the municipally owned utility was the proper and lawful provider of that service. ***Id.*** at 271. The Court said the cooperative could not provide service to the new structure merely because it had the authority under § 394.080.1(4) RSMo 1994 to continue providing service to structures it was serving *before* the land was annexed. ***Id.*** For further clarification, the Court said: "*Once the land ... was annexed, Farmers' no longer had the right to provide electric service to any new structures built on the land.*" ***Id.*** at 271.

Thus, the law is clear that IEC cannot serve new structures inside Rolla. There is nothing in § 386.800 RSMo which provides authority to the Commission to do something which is directly contrary to that law.

Section 386.800 RSMo was enacted simultaneously with changes to the structure of the anti-flip flop laws. *See* §91.025, §393.106 and §394.315 RSMo. One of the changes was to re-

[13] The Supreme Court reversed and remanded a portion of the ***Farmers'*** decision relative to a breach of contract issue. The Supreme Court clearly affirmed the portion relating to the flip-flop laws.

write the section on "structures" to make clear that "nothing in this section shall be construed to confer any right on an electric supplier to serve new structures on a particular tract of land because it was serving an existing structure on that tract." The Court in ***Farmers' Electric*** in 1998 relied upon that specific language and other cases to determine that the cooperative was not entitled to serve new structures after annexation changes the character of the area from rural to non-rural. Therefore, it cannot be convincingly argued that the General Assembly, while strengthening the language to prevent cooperatives from serving new structures in non-rural areas in the flip-flop statutes, could have simultaneously made an *implied* exception to that in enacting provisions to allow municipally owned utilities to force the transfer of the cooperative's customers under § 386.800 RSMo. Therefore, § 386.800 RSMo does not authorize the Commission to award an "exclusive" service territory to IEC inside Rolla where IEC could serve new structures.

No Authority to Establish Boundary Around Rolla

Mr. Strickland of IEC asked the Commission to prevent the City of Rolla from ever expanding its municipal system by putting "a boundary around the city" at its present city limits. (Tr. 491) He also suggested that the Commission establish this boundary to minimize safety problems. (Ex. 11, p. 21) There are several reasons why these suggestions would be inappropriate and beyond the jurisdiction of the Commission.

First, the City's application relates only to the Southside annexation. The City is only allowed to request exclusive service territories "*within* the annexed area." § 386.800.6 RSMo. (Emphasis supplied) Therefore, the statute does not contemplate or authorize the establishment of exclusive service territories *outside of* the Southside area. Therefore, the Commission is limited in its jurisdiction to establishing an exclusive service territory for **a)** RMU alone and **b)**

within the Southside area. Consequently, it has no authority to establish boundaries on the north, east and west sides of the City as requested by Mr. Strickland.

Next, Mr. Strickland's request to establish a blockade around the City for IEC's benefit is contrary to the intent of § 386.800 RSMo. The structure of the statute clearly indicates that the General Assembly intends for a municipal utility to have the *opportunity* to go through this process *each time* a city with a municipally owned electric utility goes through an annexation process. Any attempt by the Commission to essentially strangle Rolla's future growth by the establishment of a boundary all around its exterior would be contrary to the intent of the General Assembly because it would ostensibly prevent the City from utilizing § 386.800 RSMo in future situations.

Finally, as noted by Mr. Watkins in his surrebuttal, Mr. Strickland's concept of the Commission's authority to impose a territorial boundary on Rolla is misinformed. Section 386.310 RSMo says specifically that the Commission does not have the authority to allocate service territories for "safety" reasons.

17. Entire Annexation Area Should be Assigned to RMU

Section 386.800 RSMo authorizes a municipal electric utility, with the approval of the Commission, to purchase the facilities of a rural electric cooperative after an annexation such as this. The Commission should assign the entire annexed area as RMU's exclusive service area in order to eliminate the need to construct dual or duplicate electric distribution lines in the annexed area, as explained elsewhere in this brief.

RMU's application covers the entire 1,350 acres of the Southside area. There was no evidence that any specifically defined smaller area should be eliminated from the scope of

RMU's application, with the exception of the discussion about IEC's district office building. (See Section 20 below). In that one instance, in an attempt to satisfy the expressed concerns of IEC and eliminate IEC's perceived need to move its office building simply because it is inside the city limits, RMU has proposed that the Commission carve out the footprint of the IEC office building, so long as it is used as such, from the otherwise exclusive RMU area.

18. Fair and Reasonable Compensation

The total RMU has computed for the "fair and reasonable compensation" pursuant to § 386.800.5 RSMo is $1,285,210.83. (Tr. 33) For comparison purposes, IEC's corresponding figure[14] is $4,517,253.40. (Tr. 53) There was no directly comparable figure developed by the Staff. The Staff offered a figure of $1,836,762 that encompasses most of the different categories of costs. While RMU and IEC presented differing estimates of the re-integration costs, the Staff did not attempt to quantify them. Instead, it "has recommended that there be some competitive bids let" for the components that it did not quantify. (Tr. 31)

There are several reasons for the disparities in the costs between the parties. Some of the major ones will be briefly discussed here for illustration purposes. Over $1,000,000 of the $4.5 million IEC wants is represented by the value of its office building and the cost of transferring things from it to a new building somewhere else. Since RMU does not want the office building, eliminating that cost component would drop the IEC total to approximately **$3,464,024**. IEC wants RMU to pay $402,649 due to patronage obligation amounts[15] it says it has within the

[14] IEC made an offer of proof which contained additional alleged costs of $371,000. (Tr. 53) The offer of proof is not a part of the evidentiary record in this proceeding and thus cannot be considered by the Commission.

[15] See the discussion in Section 29 below.

Southside area. RMU and the Staff dispute that completely. Eliminating that amount drops the IEC number to **$3,061,375**.

For comparison and illustration purposes only, if we start with the RMU proposal of $1,285,210 we can use that to quantify certain issues. RMU has argued that the Commission should deduct $400,000 from the otherwise fair and reasonable cost it determines because of the status of IEC's easements.[16] Adding that amount back to the RMU amount for illustration purposes would produce a figure of **$1,685,210.**

IEC's starting point figure for present day reproduction cost new of its facilities is approximately $304,000 higher than the number used by both RMU and the Staff.[17] Subtracting that for these purposes produces a new figure for IEC of **$2,757,375.** All three of those parties used different numbers for depreciation to be applied to (i.e., subtracted from) the reproduction cost new figure.[18] RMU's depreciation amount was a much higher percentage of the starting point than either Staff or IEC.

On the issue of 400 percent of normalized gross revenues, RMU is about $370,000 lower than the Staff, which is about $14,000 lower than IEC.[19] Adding $370,000 for discussion purposes to the assumed RMU number produces a figure of **$2,055,210.**

For purposes of this illustration then, and just in an attempt to create roughly comparable figures, we can say that if all of the hypothetical additions and subtractions we have performed in

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[16] See the discussion in Section 26 below.

[17] See the discussion in Section 19 below.

[18] See the discussion in Sections 21 and 22 below.

[19] See the discussion in Section 24 below.

this illustration are taken into account, RMU is at **$2,055,210**, the Staff is at **$2,140,762** and IEC is at **$2,757,375**. The *remaining* differences are thus narrowed to a range of less than $1 million. That remaining amount can be attributed to the following issues: a) how much for re-integration for IEC's system, and b) how much to re-integrate stranded customers?

The foregoing discussion is not meant to convey that the Commission should rule in any particular fashion on any particular issue. It was undertaken simply for illustration purposes to attempt to apply a common perspective to the various positions because some of the Commissioners seemed to be having some difficulty at the hearing in seeing how all of the numbers fit together. This is perfectly understandable because the parties had different starting points on some of the calculations, some of the parties had different concepts about what numbers to use in the position statements, and parties were even changing their numbers at the time of the hearing. It is hoped that this discussion at least explains how the differences between the parties relate to the totals.

19. Present Day Reproduction Cost New

The statute says that for the purpose of valuing the facilities of IEC to be transferred to RMU, the Commission is required to start with a calculation of the "present-day reproduction cost, new, of the properties and facilities serving the annexed areas ... ." § 386.800.5(1) RSMo 1994. It is the "top line" number in a calculation. (Tr. 525) After calculating that positive figure, the Commission is required to apply a negative figure for "depreciation computed on a straight-line basis." Because these are two separate and distinct concepts, one positive and one negative, they will be discussed under separate headings.

"Present day reproduction cost, new" ("PDRCN") essentially means "today's cost" of

something. (Tr. 123) It is a *totally different* method of valuing utility assets than the Commission is accustomed to employing in utility rate cases.[20] (Tr. 536) Traditionally, the Commission uses "original cost" as the positive number, or first part of the process for valuing assets, before applying depreciation. (Tr. 536) Under an "original cost" approach, the Commission determines the cost of the asset when it was *first* devoted to public service. "Today's cost" of that item is not considered. For example, if a 40-foot long wood utility pole was installed 40 years ago in 1960 at a cost of $100, its "original cost" is $100. It does not matter what the cost to install it today is, or what a willing buyer and seller might value it at.

In contrast, if you use PDRCN to value that pole, you *ignore* what the *actual* cost was to install that piece of equipment. Instead, you price it as if it were being installed – brand new – today. The PDRCN for the pole that originally cost $100 could be $400, for example. (Tr. 529)

Applying PDRCN and "original cost" valuation approaches (without depreciation) to the *same* piece of equipment can therefore produce widely differing results, depending on how old the item is. In the example of electric utility distribution equipment, using PDRCN if the assets have been in place for many years would produce a much higher figure than an "original cost" valuation. This is because electric utility distribution equipment and facilities are durable and usually have a long useful life covering decades, and the prices for that equipment have generally increased with inflation and time. In a situation where costs are declining, however, PDRCN can work the opposite way. For example, it is widely known today that there is more computing

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[20] Unlike the situation presented by § 386.800 where the valuation method is prescribed by statute, the Commission is not bound by statute to any particular method in valuing assets in regulated utility rate cases. See, § 393.230 RSMo 1994. In the past, the Commission utilized "fair value" while in more recent years, the Commission has tended to use an "original cost" approach, which Mr. Ketter referred to as "book value." (Tr. 536)

power in a Game Boy™ than there was in all the computers that were in the 1969 lunar module of Neil Armstrong. The cost of computers, by power, has been declining over time. In the world of computers, then, PDRCN would produce a much lower number than "original cost" if applied to something more than five years old.

Why PDRCN?

Why did the General Assembly give *specific* instructions to the Commission in the statute that it was to use PDRCN? Mr. Ketter testified that PDRCN produces a valuation that is closer to its present market value.[21] (Tr. 537) That may be true, but market value and PDRCN are not the same thing. Mr. Marmouget testified that the market value of a particular asset could be either greater or less than PDRCN in a given instance. (Tr. 130) The General Assembly clearly wanted the Commission to take "today's cost" rather than "market value" into account in determining "fair and reasonable" compensation.

Why would the General Assembly want to use "today's cost" as opposed to original cost? Mr. Marmouget, a CPA trained in depreciation methods (Ex. 1, p. 2), testified that PDRCN "compensates" for any improvements or additions to the system. (Tr. 122) This was corroborated by Mr. Bourne, a registered professional engineer. (Tr.145) In other words, PDRCN *eliminates* the need to look at *specific improvements* to the facilities. (Tr. 126) This is an important concept because IEC claimed the method RMU and the Staff used, which was PDRCN, didn't take into account replacements that IEC had made to its system.(Tr. 55) No one disputes that IEC has repaired or replaced particular parts of its facilities in the Southside area

[21] "Market value" is a completely different approach to valuing something. Market value is what a willing buyer and a willing seller agree to pay for something. Mr. Marmouget also testified that the General Assembly could have instructed the Commission to use "market value" instead of PDRCN. (Tr. 129) The General Assembly had lots of choices for a valuation method. (Tr. 129)

over the years. The question, however, is how to take those into account within the context of the statutory framework. The answer is that the PDRCN method *automatically* takes replacements and improvements into account. (Tr. 122) If you take all of the facilities IEC has in the Southside area today and price them at "today's cost" you are *necessarily* going to capture the cost of all of the improvements or replacements IEC has made over time.

Despite the inherent properties of PDRCN to take into account "today's cost" of the facilities, IEC spent a considerable amount of time at the hearing with an exhibit on an easel trying to demonstrate its argument. (E.g., Tr. 86-91) The problem with what IEC was doing is that it did not represent PDRCN less straight line depreciation. (Tr. 126) IEC's examples used historical costs (Tr. 129) and its approach to depreciation does not utilize "straight line" as required by the statute. (Tr. 95)

The PDRCN is $742,131

Both the Staff and RMU determined that the PDRCN amount for the IEC facilities in the Southside area is $742,131. The Commission should utilize this amount, rather than the higher number suggested by IEC, because $742,131 is more accurate and reliable and most of it came from IEC in the first place.

RMU questioned IEC about the value of its facilities as a part of the discovery process in this case. Mr. Bourne said in his prepared direct testimony that IEC provided staking sheets and a cost breakdown, and the PDRCN figure for all of its facilities in the Southside area in response to a data request. "This included such things as transformers, poles, conductors, guy wires, etc. ... The value placed on their facilities by Intercounty was $547,131.01." (Ex. 3, p. 2) He further testified that RMU conducted some spot checks of the facility information provided by IEC and decided to accept the PDRCN figure IEC placed on its own facilities. (Ex. 3, p. 3)

In Mr. Ledbetter's rebuttal for IEC, he pointed out that the $547,131 amount was just for the facilities themselves. It did not include the PDRCN associated with engineering, staking, right of way acquisition, and right of way clearing for all of those facilities. He estimated those costs at $195,000. Mr. Bourne acknowledged these were appropriate costs for that purpose and added them to the prior amount to reach the total of $742,131. (Ex. 4, p. 22; Schedule RB-5) The Staff has utilized this same number.

The difference between $742,131 as used by Staff and RMU, and IEC's revised number of $1,046,115 sponsored by Mr. Ledbetter, is solely attributable to an estimate made by Mr. Ledbetter of the value of IEC's existing facilities. Essentially what he did was to take the same IEC staking sheets but, instead of using the value placed on the facilities by IEC itself, applied unit values that he extrapolated from some project by an outside contractor on Shawnee Bend at the Lake of the Ozarks. (Ex. 4, p. 20)

We have to be suspicious of Mr. Ledbetter's $304,000 adjustment for several reasons. One is that, unlike the $547,131 amount, the additional $304,000 in costs are from a source different from IEC itself. We know little about the origin of the numbers he used and how they were derived. They are from a project some 80 miles away that is not comparable to the Rolla area. (Tr. 164) Mr. Bourne testified that the areas were not comparable. (Ex. 4, p. 20) Mr. Ledbetter noted that "it makes a lot of difference in an estimate whether you're going to encounter a lot of rock." (Tr. 430) That probably explains a lot of the cost difference because as everyone knows, the land surrounding the Lake of the Ozarks is very rocky. This stands to reason because the Lake itself covers all the valleys and it is only the rocky tops of the hills that are above water. (Tr. 209) Therefore, the Commission should reject these unsupported estimates from Mr. Ledbetter and determine that the PDRCN amount for the IEC facilities in the

Southside area is $742,131.

20. IEC's Office Building

The district office building of IEC located within the Southside Annexation area should not be included with the facilities the Commission orders transferred to RMU. RMU neither needs nor desires to obtain the building so its transfer is a needless and wasteful act. (Ex. 7, p. 27) The building is also not within the type of property the statute contemplates being transferred pursuant to the establishment of an exclusive service area.

Statute Doesn't Require Transfer

Section 386.800 RSMo 1994 allows a municipally owned utility to request an "exclusive service area" or "areas" inside an area that has been annexed. It provides a procedure whereby the municipal utility can acquire the "properties and facilities serving the annexed area." § 386.800.5(1) RSMo 1994. When the statute discusses those "facilities" in more detail, it speaks of the cost of "detaching the facilities" and the costs of "reconstructing any necessary facilities to reintegrate the system of the affected electric supplier outside the annexed area... ." See § 386.800.5 RSMo 1994. One does not normally "detach" an office building. One does not normally "reconstruct" an office building in order to "reintegrate the system." The clear connotation of the statutory language is that the facilities subject to transfer are the *electrical* facilities (e.g., poles, wires, meters, and transformers) actually serving the customers with electricity. Obviously, if some of them are going to be transferred to another provider, a portion of those facilities would have to be "detached" from the rest of the system, and there would have to be "reconstruction" to "reintegrate" the remainder of the electrical facilities. Thus, the connotation of the statute does not include an office building. In addition, there is no statutory

provision which clearly indicates that "facilities" necessarily includes an office building. Therefore, it is not reasonable for anyone to argue that the statute compels the Commission to transfer the office building.

The Office Serves a Much Larger Area

There is no evidence that the office building, which IEC values at $1,000,229.16, was obtained or built solely to serve customers inside the city limits of Rolla. IEC admitted that it is a "district" office building. It is actually one of two "district" office buildings IEC maintains, in addition to its headquarters office building, to serve its 28,000 members in the 2,500 square mile territory it has. (Tr. 492, 504) Mr. Watkins testified that the office building, which also contains a service center, "is just as valuable ... in the maintenance of their facilities and service to their customers after the ... transfer ... as it was preceding the transfer." (Ex. 7, p. 29)

Mr. Ketter testified that in his opinion, the transfer of the office is not tied to the transfer of the customers in the Southside area. (Ex. 14, p. 3) He said the office building "has value to the remaining Intercounty members in and around Rolla." (Id.)

IEC's Concerns About Electric Service to the Building

IEC claims that due to contractual provisions, it must supply its district office building with electricity. It even takes the extremely radical position that if the building is included in RMU's territory, IEC will "relocate" the office and service center. (Tr. 492)

In contrast, RMU has taken a quite reasonable position. RMU has responded to IEC's stated concerns by saying that it is willing to have the Commission carve out the footprint where the office building is located so that it would not be within RMU's exclusive territory, so long as it remains an IEC office building. (Ex. 7, p. 29) That rational solution is in the public interest. It avoids the irrational approach and needless expense of IEC's position that RMU must accept

and pay for a building RMU neither wants nor needs. Under RMU's compromise approach, IEC can continue to utilize the district office building as it has, and receive electric service from its desired supplier. The only effect is that, for a temporary period of about five months, it will have 286 fewer customers who might utilize its services.

21. Depreciation Approach

The statute requires that once the Commission determines a dollar figure for the present-day reproduction cost new (PDRCN) of the applicable facilities (as discussed earlier), that amount is to be reduced by "depreciation computed on a straight line basis." § 386.800.5(1) RSMo 1994. The statute does not further define the terms "depreciation" or "straight line." Both are terms commonly known to accountants and the Commission. Both RMU and the Staff have utilized a straight line depreciation approach in this case. IEC has not.

In his book *Public Utility Accounting - Theory and Application*, (Michigan State U., 1973) Professor James E. Suelflow discusses depreciation in general. He notes on p. 81 that a dictionary definition of the term stresses the notion of a decline in value over time. He then notes that the American Institute of Certified Public Accountants uses a definition which indicates it is a process to distribute the cost of an asset over its estimated useful life. Then he points out that the Uniform System of Accounts for public utilities discusses it as a "loss of service value," which it defines as "the difference between original cost and net salvage value." (Id. at 81-82) He concludes that there can be a conflict between the different bodies using the term by emphasizing value as opposed to cost. But he says that in general, it is used to denote a loss in value. "When an individual speaks of the depreciation of his automobile in a year, he is saying that the value of the car, if it were sold today, would be less than the initial purchase

price." (Id. at 82) He concludes that

> ... any item whose service life spans several accounting periods should have its cost or service value apportioned over those periods through the depreciation mechanism. At the end of the property's useful life, except for scrap value, the item should have depreciated to zero. (Id. at 83)

Under Generally Accepted Accounting Principles, there are several different depreciation methods. (Tr. 75) Mr. Marmouget, a CPA, testified that the straight line method requires that the historical cost of the asset be depreciated on an *equal* basis per year over the estimated useful life of the asset. (Tr. 75) There are other depreciation methods, such as the double declining balance method, that result in an asset being depreciated more rapidly. (Tr. 129) Generally, though, the older the facility, the greater the amount of the depreciation which has accumulated, or expressed another way, the lower its remaining value. (Tr. 77; Ex. 3, p. 3) Mr. Ketter appears to agree with this general approach, since he testified that "depreciation is used to reduce the present-day valuation of the affected assets in order to reflect their age." (Ex. 13, p. 8)

The General Assembly specified that the Commission is to employ the straight line depreciation method. To do that in this case, we need to know several things. One is the estimated useful life of the asset. The other is the age of the asset sought to be depreciated. (Ex. 3, p. 4) There does not appear to be much controversy over the estimated useful life of distribution assets. IEC utilizes a straight line rate of 2.8 percent on that type of assets. (Ex. 3, p. 3) That works out to a useful life of 35.71 years. (Ex. 3, p. 3) In simple terms then, if all of the IEC facilities in the Southside area were 35.71 years old, they would be fully depreciated and have a "zero" value for these purposes, as indicated by Professor Suelflow above.

The Age of the IEC Facilities in the Southside Area

Although RMU asked IEC to provide the ages of its equipment in the area, unfortunately

IEC does not keep records sufficient to determine the exact age of its distribution facilities and did not provide any usable data to RMU. (Ex. 4, p. 21; p. 24) Therefore, some other means must be undertaken to determine the age of the IEC facilities in the Southside area in order to meet the statutory requirement to value them at PDRCN less depreciation on a straight line basis.

RMU first attempted to estimate the various ages of the IEC facilities in the Southside area by going to independent historical records. For example, RMU was able to determine that IEC was in the process of acquiring easements in the area from 1938 to 1952. Mr. Bourne testified that it is logical to conclude from that that IEC was obtaining easements to allow it to construct electric distribution lines. (Ex. 3, p. 4) Four of the major subdivisions in the area were platted in the mid to late 1950's. Two were platted in the early 1970's. (Ex. 3, p. 4) Mr. Bourne testified that it is logical to assume that the electric systems for these developments would have been installed shortly after the subdivisions were platted. (Id.) From this objective data, RMU was able to estimate that 70 percent of the IEC facilities in the Southside area were originally installed prior to 1965. (Ex. 3, p. 5)

If 70 percent of the IEC facilities were installed prior to 1965, this means that 70 percent of the PDRCN will be fully depreciated in 2001, the year in which the presumed transfer will take place. (Ex. 3, p. 5) This follows due to simple math, i.e., with a service life of 35.71 years, in 2001 it will have been more than 35.71 years since the equipment was installed (2001 - 36 years = 1965). Also from the subdivision platting dates, RMU assumed the other 30 percent of the facilities were installed prior to 1976. Those facilities will have been depreciated for 25 of the 36 years in 2001, leaving only 11 years of value remaining. (Ex. 3, p. 5)

Some criticism was raised about the accuracy of this approach in rebuttal testimony. To respond to that criticism in an attempt to be more accurate, Mr. Bourne undertook to review the

public records showing when the houses in the subdivisions were built and assessed for property tax purposes. (Ex. 4, p. 22) It stands to reason that electric service would be installed at the same time the houses were occupied. (Ex. 4, p. 22; Ex. 7, p. 18) RMU located the records on 197 properties in the area. (Ex. 4, p. 23) These individual tax records support RMU's original estimates and show that they were fairly conservative. (Ex. 4, p. 23-24) Mr. Bourne reported that based on the tax records, 44 % of the properties had buildings constructed prior to 1965. Eighty percent of the properties had buildings constructed on them prior to 1976. (Ex. 4, p. 24) IEC's main trunk lines in the area were installed in the 1940's. He recounted when lines were built into the particular subdivisions in the area. (Ex. 4, p. 25) Even though some houses in those subdivisions were built after 1976, the utility infrastructure was already in place. (Ex. 4, p. 26) Based on this more detailed analysis, he testified that he was comfortable that his breakdown of construction dates, shown in Schedule RB-4 attached to Ex. 4, is reasonable.

For comparison purposes, then, Mr. Bourne originally estimated that 70 % of the buildings had been constructed prior to 1965 and 30 % substantially completed prior to 1976. The property tax records reflected in his surrebuttal testimony show that 80 % of the buildings in the area were built prior to 1976. (Schedule RB-5)

IEC's Approach Does Not Comply With the Statute

The basic problems with IEC's approach on depreciation are that it does not use straight line depreciation as required by § 386.800.5(1) RSMo and it mixes in depreciation rates on items that have nothing to do with electric distribution equipment. (Ex. 1, p. 5; Tr. 92, 95) Mr. Marmouget, a CPA, testified that Mr. Ledbetter's approach does not follow straight line depreciation according to Generally Accepted Accounting Principles. (Ex. 1, p. 5) Mr. Ledbetter applied a percentage depreciation rate to all of the property in the entire IEC system.

(Ex. 1, p. 4; Tr. 95; 132) He did not separate out the property in the Southside area that is subject to transfer and apply a straight line depreciation rate to only that property. (Tr. 95, 132)

IEC uses a 2.8 percent depreciation rate on the type of equipment that is subject to transfer in this case. (Tr. 131) The other parties have accepted that as a reasonable depreciation rate. But Mr. Ledbetter's approach is an amalgam of many different depreciation rates and improperly includes other types of equipment with different depreciation rates, such as vehicles at 10 percent and transportation equipment at 16.6 percent. (Tr. 131-132; 528, 530) The result of Mr. Ledbetter including all of this other property and depreciation rates in his calculation is to produce a depreciation factor of 71.69% which, in effect, would mean that the entire IEC system is only 10.1 years old. (Ex. 1, p. 5) In other words, Mr. Ledbetter has grossly inflated the depreciation percentage by considering property which is not subject to transfer in this case and has a much shorter useful life than the relevant property. Quite frankly, Mr. Ledbetter's figure has no practical relevance to the issues.

Staff Looked Only At Transformers

Mr. Ketter for the Staff made more of an attempt to determine the age of the facilities in the area than IEC did, but his inquiry was much more limited than RMU's. Although he acknowledged that the facilities subject to transfer include "items such as poles, conductors, underground facilities, transformers, services and meters" (Ex. 13, p. 9), he actually only looked at "transformer installation dates." (Ex. 13, p. 10)

The problem with Mr. Ketter's limited approach is the same as the criticism he had for Mr. Bourne's original approach. (Ex. 13, p. 9) Mr. Ketter's criticism of Mr. Bourne's initial approach was that looking only to when subdivisions were platted "lends no specific information about when electric facilities were extended or when homes were built." (Ex. 13, pp. 9-10) Mr.

Bourne's revised approach went to the tax records and determined when the homes were built from the first year they were put on the county property tax records. It is further logical to assume that the homeowner who is paying taxes on the home has electricity. IEC had the opportunity to present specific evidence in this case of when it built its facilities in the Southside area. It did not take that opportunity. Therefore, Mr. Bourne's revised approach for RMU is the most reliable and accurate evidence in this record of when the IEC facilities were installed and should therefore be utilized for purposes of determining the amount of depreciation.

22. Depreciation Calculation

Two separate issues will be discussed under this heading. The discussion is closely related to that under the immediately preceding heading. While both RMU and Staff used a straight line depreciation approach in this case, they differed in the application of the approach to the specific facts and in the time period applied. That resulted in the Staff and RMU, while both starting at the same place, producing different depreciation amounts. Because IEC utilized a totally different and inappropriate approach, and a much higher starting point, it reached a totally different and inappropriate depreciation amount.

Before discussing the issues in more detail, let's briefly review the positions:

Staff: Mr. Ketter, utilizing only transformer installation dates, and cutting off his straight line depreciation calculation back in June of 1998, determined that **$410,176** of depreciation should be applied to the PDRCN figure of **$742,131**. This leaves the remaining value of the IEC assets in the Southside annexation area, according to Mr. Ketter, at **$331,955**. (Ex. 13, p. 10; Tr. 521)

RMU: Mr. Bourne, utilizing the property tax records, and a cut-off date on the

depreciation in 2001 when transfers are more likely to actually take place, determined that **$675,339** of depreciation should be applied to the PDRCN figure of **$742,131**. This leaves the remaining value of the IEC assets in the Southside annexation area, according to Mr. Bourne, at **$66,792**. (Schedule RB-5 to Exhibit 4)

IEC: Mr. Ledbetter, using a calculation that applied to all of IEC's property, and which does not represent a straight line depreciation approach (and that leaves out the office building), determined that only **$296,155** of depreciation should be applied to the PDRCN figure of **$1,046,115**. This leaves the remaining value of the IEC assets in the Southside annexation area, according to Mr. Ledbetter, at **$749,960**. (See IEC Position Statement, p. 3-4)

Based on the evidence the appropriate amount of straight line depreciation for the Commission to apply to the PDRCN figure of $742,131 is $675,339, as calculated by Mr. Bourne. This approach is superior because it properly reflects the amount of depreciation, at a straight line rate of 2.8 percent, that will have accumulated on the IEC distribution facilities in the Southside area by early 2001 when the Commission is expected to issue its order, and which is earlier than any type of transfer could occur. (Tr. 148) In fact, this approach may even prove to be conservative if it takes IEC longer to construct the facilities needed to re-integrate. This is obviously superior to Mr. Ketter's approach which halted depreciation on June 8, 1998, since the property obviously will not be transferred in 1998. (Tr. 543) His calculation of depreciation also doesn't match the calculation of PDRCN which was made on the basis of 2000 costs.

As explained previously, Mr. Bourne's approach to calculating the age of the subject facilities is also superior in that he looked at more relevant data than just transformer records. Mr. Bourne responded to Mr. Ketter's earlier criticism by examining the dates when the houses were built, which is more representative of the actual age of the IEC facilities than transformer

records. For the reasons mentioned previously, Mr. Ledbetter's calculation of depreciation is not even within the ballpark, and should be rejected by the Commission.

23. Detachment and Re-integration Costs

The general concept in this section is the physical isolation of the IEC distribution lines in the Southside area from the rest of the IEC system, and then for IEC to build some new lines (approximately 9 miles) outside the City to re-integrate its system. (Ex. 4, p. 26) This would minimize interferences and sharing of common poles and poles lines within the annexed area. (Ex. 4, p. 19) There is general agreement on the location and approach as recommended by Mr. Ledbetter of IEC. (Ex. 4, p. 19) There are some disagreements as to the estimated costs. The Staff took a different approach, saying that rather than try to estimate the costs, they should be the subject of competitive bids.

The total amount recommended by RMU for re-integration is $451,605 (Tr. 33) which is made up of the following components: re-integration of IEC's distribution system, $383,077; re-integrate stranded IEC customers through construction of two new line segments, $44,527.50; and transfer of service costs of $24,000. There is apparently no dispute about the $24,000 figure. These reintegration costs are based on the routes as laid out by IEC and discussed in the rebuttal testimony of Mr. Ledbetter. (Tr. 146)

Mr. Bourne testified that most of these planned upgrades will be to upgrade existing IEC pole lines. (Ex. 4, p. 27) The fact that IEC already has lines in most of these areas where the re-integration is to occur led to some concerns on RMU's part about Mr. Ledbetter's cost estimates and the need for some of the costs to be incurred.

Price of Conductors

One of the areas of disagreement is that IEC has priced the new lines with much heavier (i.e., greater capacity) conductors than those lines it presently has within the Southside area. (Ex. 4, p. 28-29) While RMU has no objection to IEC being allowed to erect *equivalent* facilities outside of the City to re-integrate its system, RMU should not be held financially responsible for IEC's desire to *upgrade* the capacity of its lines. (Tr. 166)

Mr. Bourne explained that his view of the intent of statute is to provide IEC with an equivalent system as if the transfer had not taken place. (Id.) IEC does not have the much heavier 477 ACSR type of conductor in most of the system now. (Ex. 4, p. 28; Tr. 166) Mr. Bourne said the majority of the conductors are No. 4, No. 2 or 1/0. (Id.) Accordingly, RMU has priced the conductors for the new facilities to reflect those existing conductor sizes. Of course, if IEC wants to use its own funds to invest in heavier conductors for future use, it can certainly do so. RMU, however, should only have to pay to replace what IEC has now. Mr. Bourne said he did not change the poles, insulators, or any other aspects of Mr. Ledbetter's proposal.

Easements for Re-Integration

RMU also reduced IEC's recommended amount for easements. Mr. Bourne personally inspected the proposed re-integration route. (Ex. 4, p. 27) He testified that because IEC already has existing lines which IEC will replace to reintegrate its system, he doubts the need for new easements. (Ex. 4, p. 27) "I just don't understand why new easements would be required for existing lines that should already be located in dedicated Intercounty easements." (Ex. 4, p. 27)

Right of Way Clearing for Re-Integration

RMU reduced IEC's estimate amount for right of way clearing costs in areas where IEC already had lines. Mr. Bourne said that RMU objected to reimbursing IEC for acquiring and clearing right of way where it already had existing right of way. (Ex. 4, p. 27)

Re-integration of Stranded Customers

The adoption of Mr. Ledbetter's approach does create a few "stranded"customers, i.e., customers of IEC that are not within the Southside area but whose electrical service would have to be reconfigured in order for IEC to continue to serve them. Mr. Bourne discusses the details of these engineering considerations in detail in his surrebuttal testimony and his revised feasibility study. (Ex. 4, p. 30-32) The Commission should approve Mr. Bourne's recommended approach on this topic because it presents the only detailed, fact-based, approach in the record.

24. 400 % of Gross Revenues

The statute says that for purposes of determining the fair and reasonable compensation to be paid to IEC, the Commission must determine an amount equal to "four hundred percent of gross revenues less gross receipts taxes received by the affected electric supplier [IEC] from the twelve-month period preceding the approval of the municipality's governing body ... normalized to produce a representative usage from customers at the subject structures in the annexed area." § 386.800.5(3) RSMo.

Obviously, this calculation requires several different approaches. First, one must determine what the actual gross revenues were for the appropriate period.[22] That should produce an exact number, and it did. Although it took some effort on RMU's part because of IEC's poor and confusing organization and numerous errors, such as the inclusion of customers who were not even in the annexed area (Ex. 3, p. 6; Ex. 7, p. 25), Mr. Bourne was finally able to arrive at

[22] While the statute calls for the use of the 12 month period preceding the receipt of approval from the city council (which in this case was in mid-September 1998), the numbers used by RMU covered the July 1997 through June 1998 IEC billing months. No one filed any testimony objecting to the use of this slightly different time period or listed it as an issue in the Issue List filed with the Commission.

an "actual" revenue amount for 12 months of $370,463.45.[23] (See Ex, 3P, Schedule RB-1, p. 6, right hand column) No one filed any testimony disputing the accuracy of Schedule RB-1 itself.

Second, consideration must be given to subtracting any gross receipts taxes, if any, from that gross amount.[24] There are no such taxes applicable in this situation, so that is not a consideration here.[25]

Finally, the General Assembly requires judgment to be brought to bear on the actual numbers to "normalize" them and thereby produce a number that reflects "a *representative* usage from customers *at the subject structures* in the annexed area." (Emphasis supplied) Since judgment is involved, that has produced several different approaches which the Commission will have to judge for appropriateness.

In summary, the issues to be discussed include **a)** whether the actual amount should be adjusted to take into account the net amount actually received by IEC after discounts and refunds are considered; **b)** whether RMU should have to pay for structures that no longer exist; and **c)** whether it is appropriate to normalize by assuming full occupancy of rental properties.

The figure RMU has calculated as appropriate is $1,166,814. (RMU's Position Statement, p. 6) This number represents a revision to the originally proposed number of $1,481,853.80. (Ex. 3, p. 6) That revision is due to an adjustment proposed by Mr. Watkins to take into account an estimate of the discounts and refunds which IEC claims to have made to the

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[23] This amount does not include revenue from CT Farm and Country Store and Charles Moreland; the two structures that no longer exist.

[24] The affected electric supplier is not entitled to retain any of those tax amounts. The supplier merely acts as a conduit to collect and remit the taxes to the taxing jurisdiction.

[25] IEC represented that the list did not include any gross receipts taxes. (Ex. 3, p. 8, lines 3-7)

customers. It also reflects RMU's position on IEC's attempt to normalize by assuming full occupancy of structures, and IEC's and Staff's position that RMU should have to pay an amount for two buildings that no longer exist.

Net Amount After Discounts and Refunds

When RMU filed its direct testimony in this proceeding, it assumed that the revenue numbers provided to it by IEC were representative of the actual net revenues received for the applicable period. After reviewing some of the rebuttal testimony of IEC, it appears that the customers will not actually pay what IEC told RMU they would. The difference is due to "discounts and patronage" that Mr. Strickland says they will receive from IEC. (Ex. 7, p. 25)

This came to light as a result of Mr. Strickland's "Exhibit VWS-7" which purports to show that when all things are considered, IEC's rates are comparable to RMU's rates. (Ex. 7, p. 25) This is despite the fact the nationally published figures show IEC's residential rate to be 6.9 cents per Kwh and RMU's to be 5.4 cents per Kwh. (Ex. 7, p. 25; Tr. 417-418) That difference is a "strong 27 percent." (Ex. 7, p. 25)

Mr. Watkins reacted to that contention by concluding that if IEC's rates really are comparable to RMU's as Mr. Strickland contends, then the revenues IEC actually receives must be closer to the revenues that would be produced by RMU's lower rates. (Ex. 7, p. 25) He took the 27 percent figure and applied it to the original revenue number of $370,463. That produces a figure of $291,703 which, when multiplied by four to achieve the 400 percent, produces $1,166,814.04. (Ex. 7, p. 26)

Therefore, if we are to accept as truthful Mr. Strickland's assertion that when discounts and patronage are considered, the rates are comparable, IEC should not reap a windfall here. RMU should only have to pay 400 percent of the net revenue that IEC received from these

customers.

RMU Should Not Have to Pay for Nonexistent Structures

As previously noted, the statute requires the Commission to "normalize" the revenue figures and thereby produce a number that reflects "a *representative* usage from customers *at the subject structures* in the annexed area." Two of the "subject structures" ceased to exist after the annexation. The CT Farm and County Store burned down after the area was annexed. (Ex. 3, p. 7) The remains of the building have since been torn down. (Id.) A residence owned by Charles Moreland on Rolla Street was torn down to allow for the development of a new subdivision which RMU is serving. (Id.)

Any new structure built on the CT or Moreland parcels now or in the future cannot lawfully be served with electricity by IEC, so IEC has no expectancy of any future revenue from those parcels. See, ***Missouri Public Service Company v. Platte-Clay Electric Cooperative, Inc.***, 407 S.W.2d 883 (Mo. 1966); ***Farmers' Electric Cooperative v. Missouri Dept. of Corrections***, 977 S.W.2d 266 (Mo. banc 1998). IEC has no stream of revenue coming from these vacant lots now which it will lose as a result of a Commission-ordered transfer of facilities to RMU. Mr. Watkins said that

> While RMU has no problem paying 400 percent of annual revenues to Intercounty for *actual* customers that will be transferred to RMU, I do not think RMU is required to pay for 'phantom customers.' RMU or any utility thereby assumes the risk that some of the homes of those customers might burn down in the future, and RMU might lose future revenue. But I don't see anything in the statute that says RMU has to compensate Intercounty for customers it has lost for reasons other than a transfer to RMU.

(Ex. 7, p. 19) The Commission has to give effect to the statutory language of "customers at the subject structures in the annexed area." As Mr. Watkins indicates, the statute obligates RMU to pay IEC for facilities actually being transferred. Neither of these two situations are "customers"

and there are no "subject structures" or facilities to be transferred associated with them, because the structures don't exist. (Ex. 7, p. 20) Therefore, the Commission should not take any prior revenue from the CT or Moreland properties into consideration in the calculation of 400 percent.

Inappropriate to Assume Full Occupancy

Mr. Ledbetter proposes to normalize the actual revenues by assuming 100 percent occupancy of the properties in the area 100 percent of the time. (Ex. 4, p. 29; Ex. 7, p. 24; Tr. 160, 448) He said that he had imputed revenue "for services which have become idle during the test year ... ." (Ex. 4, p. 29) This means he added in additional revenue for apartments or houses that only had part-time occupancy. (Ex. 4, p. 29; Tr. 448; Tr. 466) There are multi-family properties in the annexed area, apartments, duplexes, and trailer parks. (Ex. 4, p. 23)

The Staff did not adopt Mr. Ledbetter's approach to vacant apartments. (Tr. 539)

What Mr. Ledbetter did is an improper "normalization" that does not produce a "representative" usage from the subject structures. This is because "utilities always have periods where apartments and houses are vacant and the utility gains little or no revenue from these properties" during those periods. (Ex. 4, p. 29) A "representative" usage would reflect periodic vacancies. Not only does Mr. Ledbetter assume a "perfect world" for IEC with full occupancy of all structures, the "perfect world" then gets magnified *four times* by the operation of the statute. Nothing in the statute indicates that was the intent of the General Assembly. Therefore, the Commission should reject Mr. Ledbetter's proposal.

25. City's Ability to Withhold Payment

The Regulatory Law Judge indicated that he wanted to know the views of counsel as to whether the City of Rolla had "lost discretion" on what to pay for the IEC properties by bringing

the matter before the Commission. (Tr. 401) This question apparently was prompted by comments from Mr. Watkins to the effect that the City, as a governmental body, would have to approve any payment ordered by the Commission. (Tr. 343-344; 389)

Mr. Watkins was correct when he testified that the City has not set a "maximum" amount as to what it would approve. (Tr. 389) The position of the City is that, assuming the Commission orders the transfer of the properties and sets the amount of "fair and reasonable compensation" in a lawful order, the City will not withhold payment on the basis of its perception that the amount ordered is unreasonable. Therefore, the question is moot.

26. Offset for Easement Problems

The Commission should deduct $400,000 from the otherwise fair and reasonable compensation amount it determines in this case to reflect the state of IEC easements[26] in the annexed area and the associated potential litigation costs RMU may incur as a result of IEC's failure to follow normal business practices regarding easements.

In the course of discovery in this case, RMU has determined that IEC's easements, to the extent they even exist in the Southside area, are in terrible shape. The IEC easements in the Area are either not recorded or not recordable. Mr. Bourne testified that RMU asked IEC to provide a copy of all of the easements it had in the Southside area. "IEC provided a stack of over 100 easements. Only 15 actually pertained to the Southside area. Of those 15, *none* were recorded in the Phelps County Courthouse in the time period in which they were obtained – 1938 through 1952." (Ex. 3, p. 20) There are also instances where IEC has installed distribution lines outside

[26] RMU uses the term "easements" in this discussion in a generic sense, and does not intend to convey that any of them are valid. It may be that what IEC has in fact obtained is not a valid easement in the legal sense due to the problems discussed. It may be that IEC has only obtained a personal "license" that is terminable.

of easements, presenting the possibility of trespass lawsuits. (Ex. 3, p. 19)

When IEC even obtains an easement, it apparently has made a business decision never to record it. (Ex. 3, p. 19) While this may not be an apparent problem for IEC now, if RMU obtains the facilities in this case due to Commission order, and landowners wish to take a hostile attitude, it could force RMU into expensive surveying costs, and litigation, including condemnation, all just to fix the problems that IEC clearly and intentionally created. (Ex. 3, p. 21) None of this would be necessary, of course, if IEC had followed proper practices in the first place by including proper legal descriptions and recording easements. (Ex. 3, p. 22)

Mr. Bourne explained that there are several types of problems evident.

- IEC has a practice of obtaining "blanket" easements. Rather than describing a narrow corridor for the particular line, the easement applies to the entire parcel. This can present problems where there is a subdivision.
- Some of the easements do not contain legal descriptions.
- Some of the signatures on the documents are not notarized.
- IEC did not produce easement documents for any specific locations in the Southside area. IEC apparently has no easements in the Parkview Subdivision.
- IEC has apparently installed lines in the Longview Subdivision that are outside of the subdivision easements. (Ex. 3, p. 19)

An easement is an "interest in land." ***Dowd v. Lake Sites Inc.***, 276 S.W.2d 108, 113 (Mo. 1955). As such, it can be recorded. The principal reason for recording an easement is to provide the world with notice of the deed. If not, there is no notice and the possibility exists that the easement will not be valid as to people who were not parties to the original transaction. In fact, Missouri law holds that "no such instrument shall be valid, except between the parties thereto, and such as have actual notice thereof, until the same shall be deposited with the recorder for record." § 442.400 RSMo 1994. Therefore, in many instances, an unrecorded deed of easement is not valid.

It is generally accepted that an easement should be recorded. 25 **Am.Jur.2d** *Easements and Licenses* § 18; 28A **Corpus Juris Secundum** *Easements* § 53. The major concern is that if the easement is not recorded, it may become invalid. "The policy of recording acts prevents the assertion of an equitable defense, good against a predecessor in title, if the successor in title had no actual or constructive notice of the facts constituting the basis of the defense." ***Hankins v. Ozark Forest Products***, 658 S.W.2d 915, 918 (Mo.App.S.D. 1983) *quoting* ***United States v. Chatham***, 298 F.2d 499 (4th Cir. 1962). In Missouri, "A deed *must* be recorded to fully protect the parties thereto." I **Mo. Real Estate Practice**, § 3.7 (MoBar 3rd ed. 1996). Therefore, it is obvious that it is poor business practice not to record an easement. An unrecorded easement opens the door to future liability.

It is also generally accepted that an easement requires the same accuracy of description as other land conveyances and the instrument must be sufficiently precise that a surveyor can go upon the land and locate the easement. 28A **Corpus Juris Secundum** *Easements* § 54. This is not fatal to the instrument, but is good practice. If there is no precise description, the grantee (i.e, holder of the easement) is entitled to "convenient, reasonable and accessible use." ***Hoelscher v. Simmerock***, 921 S.W.2d 676 (Mo.App.W.D.1996). This nebulous standard presents the uncertainly as to how some of the easements may be encumbered, and to what extent.

In Missouri, § 486.330 RSMo prescribes notarization forms and mandates that they be used "substantially" in the prescribed form. A deed must be acknowledged in accordance with the laws of the State of Missouri. I **Mo. Real Estate Practice**, § 3.8 (MoBar 3rd ed. 1996).

Mr. Bourne, who has experience with utility easements, testified that there are a host of potential problems related to the status of IEC's power line easements. (Ex. 3, p. 21) One possibility is that the persons who gave the easements to IEC will claim a transfer to RMU is

invalid. Mortgage holders on the affected properties may claim that the document is not binding on them, which could lead to RMU being dragged into foreclosure or bankruptcy proceedings with the possibility of RMU losing the right to have the facilities there. If the property has changed hands since the original document was signed, the new owners may claim the easement is not binding on them, forcing RMU to either payment for the land rights or to condemn. (Ex. 3, p. 21)

It is the uncertainty created by IEC's bad business practice that has created this problem. RMU does not know precisely how these potential problems may manifest themselves in the future. The exposure is certainly there with several miles of overhead and underground lines in the Southside area. If this were an arm's length transaction between the parties, the problem could possibly be dealt with by warranties or indemnifications, or by a reduction in the purchase price. Since it is not a voluntary sale, and the Commission has the statutory obligation to set "fair and reasonable compensation," it is RMU's position that the Commission must address the problem. RMU has attempted to quantify the problem by providing an estimate of the costs it may incur in the future. The estimate is $408,892. Mr. Bourne provided details on how he arrived at that amount. (Ex. 3, p. 23; Tr. 169-170)

RMU brought this matter to the attention of the Commission and the other parties in direct testimony filed on June 1, 2000. Since that time, IEC has not denied the status of its easements as described by Mr. Bourne. It has apparently made no attempt to correct the problems. The problems are there, just like a ticking time bomb, and no one knows when they are going to go off.

The Commission has the authority to consider and place a valuation on easements. (Ex. 7, pp. 21-22). In this case, it is a part of the "fair and reasonable compensation" that it is required

to establish. It is unreasonable to make the citizens of Rolla pay for IEC's bad business practices. It should deduct $400,000 from the otherwise determined fair and reasonable compensation.

27. Testing of IEC Equipment for PCBs

IEC should be ordered by the Commission to test its electrical equipment in the annexed area prior to the transfer for the presence of PCBs, or document that the equipment in place is PCB-free. The Commission should order that any IEC facilities that test positive for a regulated level of PCB's should be removed by IEC prior to transfer. As with the easements discussed above, this is another situation where IEC's bad business practices present a liability to RMU.

Mr. Nelson of IEC acknowledged in his rebuttal testimony that a transfer of ownership of the facilities in the Southside area would not eliminate IEC's liability should "a PCB related issue arise on equipment for which ownership was transferred." (Ex. 10, p. 22) His solution was that "RMU be required to test any equipment prior to transfer of ownership." Mr. Nelson has the right idea about the need for a test, but has placed the responsibility on the wrong party. It is IEC's equipment and IEC's liability even if the equipment is transferred, and therefore IEC should perform the test so that it knows, up front, whether it has any continuing exposure.

PCBs are a type of chemical placed in the oil commonly used inside of electrical transformers, regulators and capacitors. (Ex. 7, p. 32) They are the type of hazardous things that people have to don "Moon suits" to clean up. They are federally-regulated. The government has determined that they can cause cancer. It has banned the production and use of PCB's in utility equipment and issued rules governing their handling. (Ex. 7, p. 32)

Mr. Watkins testified that the federal rules provide that if you haven't tested the

equipment then it must be *assumed* to be PCB contaminated, meaning 50 to 500 ppm (parts per million) present (a regulated amount). If you have tested the oil and it's less than 50 ppm, it is handled as though none is present (an unregulated amount). If you have tested the oil and it's over 500 ppm, then a whole new set of action level rules apply. He said RMU has to, and does, abide by those rules in its electrical operations. (Ex. 7, p. 32) According to a data request response (No. 155) RMU received from IEC, IEC has not tested any of its equipment within the Southside area for PCB-contamination. (Ex. 7, p. 33) *Therefore, it must be assumed that IEC has PCB-contaminated equipment in the Southside area.* The question is what to do about it.

It would be inappropriate for RMU to physically go on IEC's property and test the equipment of IEC. There are too many liability considerations, especially when you are dealing with material the government says causes cancer. IEC clearly should have the sole responsibility for testing its own equipment. Further, IEC already recognizes it has "cradle to grave" responsibility for any contamination in its facilities, so the only reasonable approach is for IEC to test its facilities prior to the transfer so IEC knows for sure whether it has any liability or not. (Ex. 7, p. 33) For example, if there were to be no pre-transfer tests, and a transformer explodes or leaks after the transfer, IEC has liability for that. So RMU would call IEC to show up and clean it up. But the fact that it is now being operated by RMU may expose it to liability too, simply because it now owns the property. Finally, because RMU is paying for this equipment up front, there is no provision for IEC to make a refund later to RMU for disposal of PCB-contaminated equipment. (Ex. 7, p. 33)

This is another problem of IEC's own making, and IEC should be held responsible for it. Mr. Watkins testified that

This is another instance, like the easements, where Intercounty has not followed good

> business practices. Intercounty should have to pay for those tests because a reasonable utility would have already tested its facilities and be knowledgeable of their status regarding PCB contamination. For example, RMU has already tested all of its transformers and knows they are PCB-free or contain unregulated amounts. According to a data request response ... Intercounty only tests for PCB-contamination upon removal.

(Ex. 7, p. 33-34) There is no dollar amount associated with testing the IEC equipment that is in the record of this case, so RMU is not proposing a specific deduction. Instead, since the Commission has necessary jurisdiction[27] over IEC to carry out the purposes of § 386.800 RSMo, it should order IEC to obtain a proper test for all the pertinent equipment prior to transfer to RMU. If any tests reveal a regulated level of PCB contamination, the Commission should order IEC to replace the item with certified PCB-free equipment prior to transfer. By this approach, IEC then has evidence that none of the equipment it transfers is contaminated, and RMU will not have to accept an unreasonable liability.

28. Joint Use Fees

IEC included an issue in the List of Issues as follows: "Should joint use fees collected pursuant to Intercounty's pole attachment agreements be considered in the calculation of fair and reasonable compensation?" IEC did not file any rebuttal testimony or present any other evidence regarding this claim. Therefore, it has abandoned the issue. There is no competent and substantial evidence to support any consideration of it as an issue. Consequently, this topic should be disregarded by the Commission and it should make no finding on it, other than there is no evidence on which to make a finding.

29. Equity Owed to IEC Members ("Patronage")

IEC, through its witness Mr. Strickland (Ex.11, p.16), claimed that the "retirement of the

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[27] See subsection 8 of section 386.800 RSMo.

annexed members' patronage obligation" which apparently is a debt[28] owed by IEC to its members in the annexed area, should be considered in the calculation of fair and reasonable compensation. He calculated the amount at $402,649.39, which apparently represents ten years of patronage obligation for the 286 customers.(Tr. 502) RMU believes this is not an appropriate amount for the Commission to include in the calculation of "fair and reasonable compensation" for multiple reasons.

First, there is little, if any, evidence to support this claim. IEC's prefiled testimony contained only one cryptic sentence stating the amount. (Ex.11, p.16, lines 3-4) Second, this is a debt which is owed by IEC to its *own* members. It has no connection to the transfer of the facilities. As Mr. Ketter said, "this proceeding has not changed Intercounty's fundamental obligation to the members in question" with regard to patronage obligations. (Ex. 14, p. 4) Further, the amount sought by IEC here does not represent a property or facility used by IEC in providing electric service in the Southside area, and thus is not something that is to be transferred to RMU for which RMU should have to compensate IEC.

It is IEC that owes this amount to its members in the annexed area. IEC has already collected this money from its members. (Ex. 4, p. 18) IEC has been collecting this type of money from its customers, and using it for the past ten years. RMU should not have to pay this amount to IEC because IEC has chosen not to repay its debt to its own members. (Ex. 7, p. 42) The members should have this money returned to them by IEC in due course, just as the cooperative does with all other patronage obligations. (Ex. 4, p. 18)

If RMU were required to pay this amount, it would simply be "double dipping" or a

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[28] Mr. Strickland said in a data request response that this is "... the amount due from the cooperative to the members in the annexed area... ." (Ex. 4, p. 18; Tr. 501)

windfall to IEC. It would increase the amount of money that the other members would be entitled to in patronage dividends but would not affect the amounts that the 286 customers would continue to receive in the future due to their past service. (Tr. 501) In essence, it would just be a "bonus" to the remaining members because it would be a cancellation of an IEC debt. No where in § 386.800 RSMo does it say that as a part of the fair and reasonable compensation, the municipal utility is required to pay off the debts of the acquired electric supplier. That is certainly something that the General Assembly could have listed if it had desired, but it did not.

Cooperatives do not make it a practice to send a bill to departing members for their share of the patronage obligation of the cooperative. (Ex. 7, p. 42) Departing members continue to receive patronage amounts they have earned in the past, even after they leave the cooperative. Therefore, there is nothing about the departure of the 286 customers here that should trigger some payment from RMU to IEC. The Commission should reject this proposal from IEC.

30. IEC Wholesale Power Costs

IEC included an issue in the List of Issues as follows: "Should Intercounty's additional wholesale power costs be considered in the calculation of fair and reasonable compensation?" IEC did not file any rebuttal testimony on this issue. IEC filed a motion on November 6, 2000 asking for permission to file supplemental rebuttal testimony. RMU opposed the motion in a filing on November 22, 2000. On December 1, 2000, the Commission denied IEC's motion.

IEC subsequently requested that the proffered supplemental rebuttal testimony be preserved in the record as an "offer of proof." As such, it is preserved for appellate purposes only and the Commission may not rely upon it in reaching a decision in this case. There is no competent and substantial evidence to support any consideration of this as an issue.

Consequently, this topic should be disregarded by the Commission and it should make no finding on it, other than there is no evidence on which to make any finding.

31. Other Issues

32. Issues Raised by Southside Neighbors/Letters

Several of the concerns raised by the testimony of Mr. Priest on behalf of the Southside Neighbors have been previously addressed elsewhere in this brief under different headings. The remaining ones will be addressed here.

Mr. Priest raised claims in his testimony, based on the report of the State Auditor, to imply that RMU was making inappropriate or improper transfers of its funds to the City. The evidence shows that RMU did make transfers of funds to the city, upon the request of the city council, for various purposes, such as a police station, a recycling center, or a new industrial development. (Tr. 360) RMU's independent and outside auditor testified there was nothing illegal or improper about those transfers. (Tr. 123) At most, the State Auditor only made a "management recommendation" that is not binding. (Tr. 82, 103, 107) Mr. Watkins testified that the decisions that the board of public works has made to send funds to the city are also in the best interest of the municipal utility. (Tr, 395) It has brought new business to the community which helps keep rates low and each project has been a good load for the utility. (Tr. 395)

33. Transfer Within 90 Days

The Regulatory Law Judge directed (Tr. 553) the parties to brief the meaning the provision in subsection 6 of § 386.800 RSMo which says: "The payment of compensation and transfer of title and operation of the facilities shall occur within ninety days after the order and any appeal therefrom becomes final unless the order provides otherwise."

It is clear from that language that the Commission, unless it orders otherwise, is to ensure that the transfer takes place on a timely basis. The General Assembly deemed "timely" to be within 90 days after the order issued by the Commission. Obviously, the General Assembly could not foresee perfectly what the scope of all future annexations by municipalities would be when it drafted this legislation. Some might involve the transfer of a handful of customers and require very little reintegration by the affected supplier and could be accomplished within 90 days. Others, such as the case presented here, could require months of construction time for re-integration of facilities. The General Assembly obviously desired to provide some flexibility to deal with more complex situations where, due to the magnitude of the changes, the transfer could not reasonably be accomplished in just 90 days.

While there is no Missouri judicial interpretation of § 386.800.6 RSMo and while there seems to be no similar statutory language in any other state, the following interpretation is possible:

Plain Language: The adverbial phrase "unless the order provides otherwise" must modify some verb in the sentence. There are only two actions in the sentence that could be modified by this phrase: "... shall occur within ninety days..." and "...becomes final..." The Commission obviously does not have the statutory authority to order *when* an appeal from one of its orders should become final. That is a matter left to the General Assembly. Therefore, the only logical conclusion is that the phrase "unless the order provides otherwise" modifies the phrase "shall occur within ninety days." The plain language of § 386.800.6 thus is that the Commission has the authority to issue an order allowing the transfer to occur more than 90 days after it issues its order.

Legislative Intent: Some of the deadlines contained in § 386.800 RSMo evidence the

General Assembly's clear intent to prevent either party from imposing unreasonable delay on the other. For example:

§ 386.800.3.1 – the municipal utility must publish notice within 60 days

§ 386.800.3.2 – the municipal utility must get approval from its governing body to enter negotiations within 6 months

§ 386.800.4 -- parties have no more than 180 days for negotiations (but can get an extension of an additional 180 days)

§ 386.800.6 – failing agreement, the municipal utility must apply to the Commission within 60 days

Those provisions all have definite expiration periods. In contrast, the only time limits imposed on the Commission itself concern how fast it must act on the application (§ 386.800.1(4)) and how soon the transfer is to take place (§ 386.800.6). The General Assembly allowed the Commission flexibility with the first deadline, which places a limit of 120 days on the consideration of the case, since it can be extended for "good cause shown." The Commission did that in this case.

Similarly, the second deadline, which requires the payment and transfer of facilities in 90 days after the order becomes final, can also be altered if the Commission's order "provides otherwise." Therefore, the two types of time limits found in § 386.800 are intended to a) prevent the parties from unreasonably delaying and b) require the Commission to consider and decide the issues and accomplish the transfer within a reasonable period. But the General Assembly clearly intended to allow the Commission more flexibility with the deadlines than it gave the parties.

To interpret § 386.800.6 to require the Commission to order the transfer of facilities within 90 days – no matter what – would frustrate the General Assembly's clear intent. If the

factual situation requires a longer time for the transfer, the legislative language seems clear that the Commission has discretion to allow whatever time period for the transfer is reasonably justified by the facts. The parties most affected by this proposed transfer contemplated that it would take more than 90 days (Tr. 550). This additional time would also be available if the Commission determined to utilize the Staff's approach to take competitive bids on re-integration costs. (Id.)

This brings us to an additional question of funds transfer. If it will take many months to accomplish this transfer, it is not appropriate for the Commission to require RMU to pay the entire amount in one lump sum, perhaps months or years before the actual transfer takes place. That is not a commercially normal situation. It is clearly RMU's preference that the money should change hands proportionately with the property. (Tr. 233; Ex. 7, p. 51)

Since the re-integration costs are the first to occur so that IEC does not lose any of the integrity of its subtransmission system around Rolla, the Commission should require those funds to be paid by RMU commensurate with that work. IEC estimates that it might take two years for that to work to be accomplished. (Tr. 503) For that reason alone, it would be inappropriate for RMU to pay for the facilities in the Southside area, and the 400 percent of the revenue from the customers, and then wait two years before it can make use of those facilities and obtain those customers. Therefore, unlike IEC which says it wants its money in 90 days (Tr. 504), even though it will take many months to accomplish the transfer, the Commission should take the reasonable approach and require the transfer of funds commensurate with the events as they occur. (Tr. 365)

34. Objection to Use of Summary

The Regulatory Law Judge stated on page 143 of the transcript that he was taking an objection by IEC to the use of summary information by Mr. Bourne in his prepared testimony with the case and indicated that the matter should be addressed in briefs. IEC's objection should be overruled.

There is no error in allowing Mr. Bourne's testimony based on a summary of certain voluminous records, as IEC's counsel alleged at the hearing. IEC cited ***Sigrist v. Clarke***, 935 S.W.2d 350 (Mo.App. S.D. 1996) for support, stating that "generally a summary of records is admissible where the records upon which the summary is based are voluminous, are admissible and are available to the opposing party for inspection." (Tr. 141)

Sigrist was a circuit court case involving medical malpractice. The records summarized were medical records and the patient attempted to enter the summary into evidence. However, the summary included color-coding in such a way as to emphasize the pain and other conditions. The original medical records had no such color-coding. The trial court refused to admit the color-coded summary of medical records. The appellate court agreed, concluding that "the way in which this data was presented may have been argumentative in nature or unduly prejudicial by emphasizing [patient's] pain or other conditions in color." ***Id.*** at 356.

The rule of law cited by IEC is accurate; however, its application to the instant case is flawed. First, ***Sigrist*** stands for the proposition that if the summary of records is argumentative, then it should not be admitted. IEC has made no such assertion here, nor could it. Second, the records in this case were available to IEC (the opposing party) for inspection through the usual Commission discovery avenues. (Tr. 142)

IEC suggested that Mr. Bourne should attach the voluminous documents to his testimony. (Tr. 141) The law does not require this action. IEC had ample opportunity to make the supporting data the subject of a data request, or take Mr. Bourne's deposition. The testimony objected to was presented by Mr. Bourne in written, prefiled form on October 18, 2000. The complaint was not raised by IEC until the trial on December 4, 2000.

Finally, ***Sigrist*** is a medical malpractice case that took place in a trial court. This case is before the Commission, which is important because the Commission generally adheres to the Missouri Administrative Procedure Act (Chapter 536 RSMo). Chapter 536 provides that there is no error in the admission of the summary in this case along with the testimony of the witness. Section 536.070(11) RSMo 1994 provides:

> The results of statistical examinations or studies, or of audits, *compilation of figures*, or surveys, involving interviews with many persons, or *examination of many records*, or of long or complicated accounts, or of a large number of figures, or involving the ascertainment of many related facts, *shall be admissible as evidence* of such results, if it shall appear that such examination, study, audit, compilation of figures, or survey was *made by or under the supervision of a witness, who is present at a hearing, who testifies to the accuracy of such results, and who is subject to cross-examination*, and if it shall further appear by evidence adduced that the witness making or under whose supervision such examination, study, audit, compilation of figures, or survey was made was basically qualified to make it. All the circumstances relating to the making of such an examination, study, audit, compilation of figures or survey, including the nature and extent of the qualifications of the maker, *may be shown to affect the weight of the evidence but such showing shall not affect its admissibility*. [emphasis added].

It is obvious that the exact situation presented here is within the ambit of § 536.070(11) RSMo 1994. IEC never suggested the witness was unqualified to make the summary. In fact, IEC never suggested there was any violation of this statute. Therefore, the summary and testimony must be admitted.

35. Violation of Undue Influence Rule

The Commission has a rule which governs the conduct of people in proceedings before the Commission. Section (4) of 4 CSR 240-4.020 provides as follows:

> It is improper for any person interested in a case before the commission to attempt to sway the judgment of the commission by undertaking, directly or indirectly, outside the hearing process to bring pressure or influence to bear upon the commission, its staff or the presiding officer assigned to the proceeding.

The general manager of IEC admitted that he proofread and authorized the placement of an advertisement in the Rolla Daily News which ran on three separate occasions. (Tr. 495; Tr. 497). He also was instrumental in seeing that the text of the ad also appeared as the cover story for the December 2000 *Rural Missouri* magazine which was mailed to about 26,000 of IEC's members. (Tr. 497-498)

The ad contained the following language: "**Intercounty** will continue to work with our members in resolving this issue and **encourages members** in the area **to contact the Missouri Public Service Commission** or the Office of the Public Counsel **and express their concerns**. As a member-owned, member-operated cooperative, this is truly grassroots membership in action. **You may contact the Missouri Public Service Commission** and the Office of the Public Counsel at the phone numbers and addresses below." (Tr. 495-496; Ex. 26) (emphasis supplied)

This advertisement *encouraging people to contact the Commission itself* was not the notice of the local public hearing. This advertisement and story was solely an attempt by IEC to influence the Commission outside of the hearing process through a letter-writing campaign or otherwise. It clearly was a conscious and deliberate attempt to "bring pressure or influence to bear upon the commission" outside the hearing process. As such, it violated of 4 CSR 240-

4.020(4). It also clearly was an attempt[29] to engage in *ex parte* communications with the Commission.

It is obvious then that the letters sponsored as exhibits by the Public Counsel were not spontaneous events. It was a part of a carefully orchestrated campaign, directed by IEC management, to bring pressure to bear on the Commission outside of the hearing process. The Commission should consider these improper actions by IEC in its deliberations.

36. Conclusion

The Commission should approve the application of Rolla Municipal Utilities and order the transfer of the facilities in accordance with the revised feasibility study presented by the City and the positions of RMU as expressed herein.

Respectfully submitted,

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[29] Apparently the Staff intercepted the letters addressed to the Commission before they reached the Commissioners.

Certificate of Service

The undersigned certifies that a true and correct copy of the foregoing was served upon the following counsel of record in this proceeding this 19th day of January, 2001, by either hand delivery or placement with the U.S. Postal Service, first class postage prepaid:

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