Commissioners
KELVIN L. SIMMONS
Chair
CONNIE MURRAY
SHEILA LUMPE
STEVE GAW

Missouri Public Service Commission

POST OFFICE BOX 360
JEFFERSON CITY, MISSOURI 65102
573-751-3234
573-751-1847 (Fax Number)
http://www.psc.state.mo.us

ROBERT J. QUINN, JR.
Executive Director
WESS A. HENDERSON
Director, Utility Operations
ROBERT SCHALLENBERG
Director, Utility Services
DONNA M. KOLILIS
Director, Administration
DALE HARDY ROBERTS
Secretary/Chief Regulatory Law Judge
DANA K. JOYCE
General Counsel

November 7, 2001

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

FILED[3]
NOV 07 2001
Missouri Public
Service Commission

RE: Case No. EO-2001-684

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of a **REPLY BRIEF OF THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION.**

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Dennis L. Frey

Dennis L. Frey
Associate General Counsel
(573) 751-8700
(573) 751-9285 (Fax)
dfrey03@mail.state.mo.us

DLF:ccl
Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED[3]
NOV 0 7 2001
Missouri Public Service Commission

In the Matter of the Application of Union Electric Company (d/b/a AmerenUE) for an Order Authorizing it to Withdraw from the Midwest ISO to Participate in the Alliance RTO	)))))	Case No. EO-2001-684

REPLY BRIEF OF THE STAFF OF THE
MISSOURI PUBLIC SERVICE COMMISSION

COMES NOW the Staff ("Staff") of the Missouri Public Service Commission ("Commission"), and for its Reply Brief, respectfully states as follows:

Introduction

The Staff's Reply Brief is offered in response to the Initial Brief of Union Electric Company ("AmerenUE Brief"). Specifically, with respect to the technical issues, the Staff will address: 1) the matter of the additional transmission revenues AmerenUE expects to retain by switching from the Midwest ISO ("MISO") to the Alliance RTO ("ARTO") and the relationship of these revenues to the question of the public interest; 2) the historical performance of the Companies in the ongoing process of establishing ARTO; and 3) the for-profit structure of the ARTO, as it relates to the public interest. Thereafter, the Staff will address the legal issues, and in particular, the questions relating to the Commission's jurisdiction, including federal preemption and estoppel.

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Argument

1. According to AmerenUE, the public interest is about retention of excess earnings.

AmerenUE's theory as to what constitutes the public interest can be distilled from its Initial Brief. If the Company is allowed to join the ARTO, it will be able to retain an estimated $60 million in additional transmission revenues, at least for the next few years. In the summary of its Initial Brief, AmerenUE states:

> Moreover, because the Company will retain significantly more open access transmission revenues from third parties under the Alliance RTO tariff and revenue allocation design than the Company would have retained in the Midwest ISO, the Company's bundled retail customers will benefit from the lowering effect this retained revenue has on bundled retail rates. [p. i]

In other words, AmerenUE argues that the public interest is served because the additional revenues it is able to retain from its transmission business under the ARTO's rate design may some day be passed on to the Company's ratepayers. However, this argument is grossly deficient in that it tells only a part of the story regarding transmission revenues. Specifically, the Company's exclusive focus on the possible benefit to Missouri ratepayers of the additional transmission revenues ignores the following key points:

1. AmerenUE cannot realize additional transmission dollars without maintaining pancaking via the Zonal Transmission Adjustment mechanism.
2. These additional pancaking dollars from transmission cannot be realized unless AmerenUE is allowed to earn in excess of its transmission cost of service.
3. Higher transmission costs for "third parties" in order to support these over-earnings mean higher generation costs to AmerenUE. When one aspect of the business is allowed to over-earn, another aspect of the business has to pay for it.

Each of these deficiencies is discussed below.

First, pancake transmission revenues are essential in order for AmerenUE to realize the additional revenues it has been touting. Although the Company argues that there are no pancaked rates from the Settlement Agreement (AmerenUE Brief at 5), its argument is simply one of semantics. True, the Settlement Agreement eliminates explicit charges for separate transmission rates by both the MISO and the ARTO for those who are members of either organization as of February 28, 2001. However, as Dr. Proctor discussed in his rebuttal testimony, both MISO and ARTO will be allowed to add an additional charge to all transactions, called the Zonal Transmission Adjustment ("ZTA"). As Dr. Proctor points out, the purpose of this additional ZTA charge is to collect the revenues that would otherwise be lost from the elimination of pancaked transmission rates. (Proctor, Rebuttal, Ex. 3, pp. 32-33). The Company has provided no rebuttal to disprove Dr. Proctor's testimony. Thus, although explicit pancaking across RTOs will be eliminated for some customers, it is clear that all customers will be paying another form of pancaked transmission rates; namely, the ZTA charge. Rather than retention of pancaked transmission revenues through the ZTA charge being in the public interest, it is a FERC concession to induce utilities with significant revenues from pancaked transmission rates to join RTOs. As Dr. Proctor states in his rebuttal testimony:

> Thus, Order 888 not only instituted the separate transmission business components as individual profit centers, it resulted in these profit centers being very profitable as the additional transactions by power marketers expanded sales of transmission services by utilities. (Proctor Rebuttal, Ex. 3, p. 37).

An RTO that eliminates the revenues from pancaked transmission rates is a significant barrier to voluntary RTO formation for utilities (such as AmerenUE) that have gained significant profits from the collection of revenues from pancaked transmission rates allowed under the Open Access Transmission Tariff ("OATT") of FERC Order 888.

Second, as Dr. Proctor points out in his rebuttal testimony, utilities have not been required to adjust downward their original rates filed under the OATT from Order 888. (Proctor Rebuttal, Ex. 3, pp. 36-37). There is no incentive for utilities to file for rate decreases unless they are required to do so by regulators. AmerenUE's Brief confirms that the Company did not change its basic transmission rate from what it had filed under its OATT. (AmerenUE Brief at 5). Since revenues from pancaked transmission rates have grown significantly since the Company's initial filing of these rates, these revenues from pancaked transmission rates represent earnings above AmerenUE's transmission cost of service. Thus, this new ZTA pancake would allow AmerenUE to continue to earn more than its transmission cost of service. When any part of the utility business is allowed to earn in excess of its cost of service, someone has to pay these additional costs – "there is no such thing as a free lunch." When this happens, it becomes very difficult to sort out who are winners and who are the losers. Allowing over-earnings is not a good foundation for determining the public interest.

The third deficiency associated with AmerenUE's focus on additional revenues to indicate a benefit to Missouri ratepayers is the Company's argument that the collection of the ZTA charges "will not come from the Company's bundled retail or wholesale customers, but third party users of the Company's transmission system." (AmerenUE Brief at 5). While there may be no adverse transmission rate impact from the ZTA charge for Missouri customers, the Company has made no showing that there will be no overriding adverse impacts on the wholesale generation market as a result of the continuation of the ZTA pancake rate. Using the Company's language, when a "third party" wants to sell electricity to AmerenUE, it will face an additional ZTA transmission charge. This additional ZTA charge will add to the cost of the "third party," thereby raising the offer price to AmerenUE and thereby reducing benefits to

AmerenUE's customers from the wholesale electricity market. This illustrates why there is no such thing as a free lunch. Somebody must foot the bill associated with the Company's excess earnings from transmission, and AmerenUE has failed to demonstrate that the adverse impacts on the wholesale generation market as a result of the excess pancake transmission rates will not produce a net detriment to Missouri ratepayers.

Based on the Company's Initial Brief, along with the additional considerations offered above, the primary question regarding the public interest for the Commission to determine is whether a ZTA pancake that allows AmerenUE to collect excess earnings in its transmission business, coupled with a resultant negative impact on the wholesale generation market, is not detrimental to the public interest. Although the Staff has sought to "flesh in" the Company's "analysis" of this question, the Staff respectfully disagrees with this view of the public interest and advises the Commission either to determine the public interest based on the performance of the Alliance companies thus far in the development of the ARTO, or to hold its decision until the ARTO has proven that it will function as a truly independent RTO.

2. AmerenUE argues that the Commission should ignore the historical performance of the Alliance Companies and trust the Federal Energy Regulatory Commission (FERC) to correct the problems that have occurred in the past.

There is no question that the Alliance is not now governed by an independent Board of Directors. Nor is there any question that Alliance established a non-independent entity, BridgeCo, to begin the implementation of the ARTO. (AmerenUE Brief at 16). AmerenUE does not dispute the poor performance by Alliance with respect to setting in place an independent Board of Directors along with a process for stakeholder input regarding the startup decisions. Instead, the Company argues that these decisions will have no impact because they were not "market sensitive" decisions. (AmerenUE Brief at 16). AmerenUE would lead this

Commission to believe that BridgeCo has made no decision regarding market design programs. But that is not what the Alliance has stated. Rather, the statement by Alliance is that they agree that they "are prohibited from implementing RTO market design programs **that have not been approved by the [FERC]** ..." (AmerenUE Brief at 16, [*Emphasis added.*]). There is no way for the ARTO to begin operation on December 15, 2001 without implementing RTO market design programs. Thus, what the Alliance statement really means is that BridgeCo, without stakeholder input, developed and proposed market designs for FERC approval and cannot implement them until it receives FERC approval. This process, in which stakeholder input was shut out and the Alliance went forward without an independent Board of Directors, is simply wrong.

On the theory that independence is the "bedrock" of FERC Order 2000, AmerenUE is telling the Commission that it should ignore the past performance of the Alliance and trust that the FERC will approve an independent Board at some time in the future, and that this new Board will correct all of the problems of the past. If this is the case, then why has the Alliance prohibited National Grid USA from making any changes to what the BridgeCo has already put in place?

> The managing member will direct the business and affairs of Alliance LLC pursuant to an LLC agreement. Alliance LLC shall adhere to the protocols filed with FERC, including a pricing protocol, operating protocol, planning protocol and revenue distribution protocol. (Ex. 11, p. 1).

Excepting any state-federal jurisdictional legal issues, in essence AmerenUE's initial brief conveys a single message to the Commission; namely: **Trust the FERC. It will do the right thing.**

If that is the case, why are we having this proceeding? The answer is simple. Over the past several years, during which the ARTO has made four major filings with the FERC, the

Alliance Companies had more than ample opportunity to establish an independent Board of Directors and an effective stakeholder process for input into the startup of ARTO; yet this has not happened. The fact is that trust in a process is built on performance. When performance is lacking, it is very difficult to continue trusting in that process. Perhaps that is why it is crucial to have checks and balances, such as state approval for utilities joining RTOs. In the instant case, the Commission has only two viable choices to protect the public interest:

1) deny AmerenUE's request to transfer from MISO to ARTO based on the historical performance of the Alliance Companies in forming the ARTO; or

2) wait until there is viable evidence that the ARTO will no longer be a way for transmission owners to maintain control of the formation and operation of an RTO.

3. AmerenUE's initial brief asks the Commission to trust that the for-profit structure of the Alliance will not be detrimental to the wholesale markets for electricity.

In its Initial Brief, AmerenUE indicates that the basis for a for-profit RTO to "enhance the efficiency" of ARTO transmission services is what it calls "performance based rates." (AmerenUE Brief at 9-10). The Company's argument is that since independence is the "bedrock" of RTO formation and FERC will some day approve an independent Board for the ARTO, it follows then that the FERC would never give ARTO a performance-based incentive that would be detrimental to the wholesale markets for electricity. Specifically, AmerenUE argues that "for the FERC to approve a performance based rate that provides an incentive to the RTO to take a position in the market, FERC will have to ignore the very bedrock upon which RTOs were formed." (AmerenUE Brief at 9). This is another instance in which the Company is asking this Commission to trust the FERC not to exercise poor judgment, in this instance regarding performance-based incentives.

Dr. Proctor's position on this question is, however, quite the opposite. Inherent in the for-profit structure of an RTO are incentives to over-build transmission as a solution to congestion, and with performance-based incentives that are not carefully crafted, there can be incentives for the RTO to take a position in the market. (Tr. 175-177). Contrary to AmerenUE's assertion, this position does not defy "reasonable logic." (AmerenUE Initial Brief, p. 9). Moreover, AmerenUE does not dispute Dr. Proctor's assertion that the for-profit structure of RTOs can result in the over-building of transmission as a solution to congestion, nor does it dispute the fact that it is difficult to design performance-based incentives that do not give the wrong incentives to a for-profit RTO. The Staff believes that establishing, as a condition for approval, the requirement that AmerenUE withdraw from the ARTO if the wrong performance-based incentives are adopted will send a strong and important signal for the ARTO to be careful in the design of such incentives.

4. Legal Issues:

a. Independent of the Stipulation And Agreement in Case No. EO-98-413, the Commission's authorization is necessary for AmerenUE to leave MISO and join ARTO.

AmerenUE's discussion of case law regarding federal preemption is far from complete. The FERC has jurisdiction over wholesale electric energy transactions. A state public service commission must allow, as reasonable operating expenses, costs incurred by a public utility as a result of paying a FERC-determined wholesale rate. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986). The FERC's approval of an energy supplier's rate does not necessarily mean that it was reasonable for the purchaser to incur the expense. A state public service commission can challenge the prudence of a public utility's decision to purchase power at a FERC approved rate under what has come to be known as the *Pike County* doctrine. *Pike*

County Light and Power Company v. Pennsylvania Pub. Util. Comm'n, 465 A.2d 735 (Pa.Cmwlth. 1983). There is authority for applying the *Pike County* doctrine in the gas utility context. (*Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 837 F.2d 600 (3rd Cir. 1988), *cert. denied*, 488 U.S. 354 (1988). This Commission, in the context of gas utility cases, has recognized the *Pike County* doctrine. The Commission stated in *Re American-Nat'l Can Co. v. Laclede Gas Co.*, Case Nos. GC-89-85 and GR-89-186, 30 Mo.P.S.C. (N.S.) 32, 34-35 (1989) as follows:

> The FERC in discharging its authority to regulate wholesale natural gas rates flowing through interstate pipelines pursuant to the Natural Gas Act, regulates the manner in which interstate pipelines may recover these [take-or-pay (TOP)] charges from their customers, whether other pipelines or local distribution companies (LDCs). The FERC has no jurisdiction over the LDCs which come under the authority of their respective state regulatory commissions. *Natural Gas Act of 1938*, 15 U.S.C. 717(b) (1984). However, pursuant to the "filed rate doctrine" enunciated in *Nantahala* and *Mississippi Power*, the states are preempted from barring the recovery by the LDC of the wholesale rates charged to it by its wholesale supplier pursuant to tariffs approved by the FERC. *Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953 (1986); *Mississippi Power and Light Company v. Mississippi ex rel. Moore*, 108 S. Ct. 2428 (1988).
>
> The states may inquire into the prudence of the LDC in entering into a given contract when less costly alternatives were available. *Pike County Light and Power Company v. Pennsylvania Public Utility Commission*, 465 A.2d 735 (Pa.Cmwlth. 1983). . . .

In *State ex rel. Midwest Gas Users' Assoc. v. Public Serv. Comm'n*, 976 S.W.2d 470, 473-74 (Mo.App. 1998), the Western District Court of Appeals affirmed this Commission's approach:

> Pursuant to tariffs approved by FERC, the pipelines passed on their gas costs to local distribution companies like MGE through a PGA clause. Under the "filed rate doctrine" the States may not prohibit MGE or other local distribution companies from, in turn, passing on these FERC-approved costs to their customers. *Mississippi Power and Light Co. v. Mississippi ex. rel. Moore*, 487 U.S. 354, 108 S.Ct. 2428, 101 L.Ed.2d 322 (1988); *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986).

> However, the Natural Gas Act allows the local regulatory authority to determine just how the local distribution company will be permitted to allocate those costs among its customers. The state regulatory agencies, such as Missouri's PSC, also have the authority to review the prudence of a local distribution company's decision to enter into a particular contract when a less costly alternative is available. *American-National Can Co. v. Laclede Gas Co.*, 30 Mo. P.S.C. (N.S.) 32 (1989), *quoting, Pike County Light and Power Co. v. Pennsylvania Public Utility Comm'n*, 77 Pa.Cmwlth. 268, 465 A.2d 735 (1983).

See State ex rel. Midwest Gas Users' Assoc. v. Public Serv. Comm'n, 976 S.W.2d 485, 489 (Mo.App. 1998)

The Staff also notes the FERC's recent Order Granting Clarification in *Ameren Energy Marketing Company*, FERC Docket No. ER01-1810-003, 96 FERC para. 61,306 (September 14, 2001). On April 17, 2001, Ameren Energy Marketing (AEM) submitted for filing with the FERC a proposed power sales agreement (PSA) with AmerenUE which provides for the sale of capacity and energy by AEM to AmerenUE. AEM filed the PSA because it involved sales at market-based rates to an affiliate with a franchised service area. On May 8, 2001, this Commission and the Public Counsel separately filed protests. The FERC conditionally accepted the PSA by Order issued June 14, 2001. On July 16, 2001, this Commission filed a request for clarification that the June 14, 2001 Order (1) does not constitute a determination that AmerenUE did not violate Section 32(k) of the Public Utility Holding Company Act (PUHCA) when AmerenUE entered into the contract without obtaining this Commission's approval, and (2) does not preclude this Commission, in setting just and reasonable retail rates, from inquiring into the reasonableness of AmerenUE's decision to enter into the particular contract with AEM. Among other things, the FERC noted in its September 14, 2001 Order Granting Clarification that "AmerenUE then argues that, while the Missouri Commission's request focuses on preemption, other preclusion doctrines (collateral estoppel or res judicata) may apply to prevent the Missouri Commission from relitigating the issues it raises." 96 FERC para. 61,306 at 62,188. The FERC rejected AmerenUE's arguments. The FERC said that it had made no determination whether AmerenUE had violated Section 32(k) of PUHCA and acknowledged that this question was before the Securities and Exchange Commission (SEC) for determination. The FERC, commenting as follows, stated that its conditional approval of the rates in the PSA should not be construed to preempt any prudence review by the Missouri Commission:

> . . . The [FERC] has consistently recognized that wholesale ratemaking does not, as a general matter, determine whether a purchaser has prudently chosen from among available supply options.[18] That is generally a question that the state commissions address.
>
> [18] *See* Central Vermont Public Service Corporation, 84 FERC ¶ 61,194 (1988); Philadelphia Electric Co., 5 FERC ¶ 61,264 (1981); Pennsylvania Power & Light Co., 23 FERC ¶ 61,006, *order on reh'g*, 23 FERC ¶ 61,325 (1983) ("We do not view our responsibilities under the Federal Power Act as including a determination that the purchaser has purchased wisely or has made the best deal available."); Southern Company Service, 26 FERC ¶ 61,360 (1984); Pacific Power & Light Co., 27 FERC ¶ 61,080 (1984); Minnesota Power & Light Co. and Northern States Power Co., 43 FERC ¶ 61,104, *reh'g denied*, 43 FERC ¶ 61,502, *order denying reconsideration*, 44 FERC ¶ 61,302 (1988); Palisades Generating Co., 48 FERC ¶ 61,144 (1989).

96 FERC para. 61,306 at 62,189.

The *Nantahala, Mississippi*, and *Duke Energy Trading and Marketing, L.L.C. v. Davis* decisions cited by AmerenUE in its initial brief do not address transmission service or facilities. A case just argued before the United States Supreme Court does address transmission issues: *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C.Cir. 2000), *cert. granted, sub nom. New York v. FERC*, 121 S.Ct. 1185 (2001), *cert. granted, sub nom. Enron Power Marketing, Inc. v. FERC*, 121 S.Ct. 1185 (2001). In this case, which is now before the United States Supreme Court, the United States Court of Appeals, District of Columbia Circuit held, in part, as follows:

> In Order 888, FERC reinterpreted FPA Section 201 to accommodate the new industry practices and conditions. FERC left the regulation of bundled retail transmissions to the states, concluding that "when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail." Order 888, para. 31,036 at 31,781. . . . . Also,

> while acknowledging that FPA Section 201(b) explicitly places retail transmissions by "facilities used in local distribution" beyond the [its] jurisdiction, FERC adopted a seven factor jurisdictional test for determining which facilities fall within that category, and claimed exclusive authority over those that do not. *See id.* at 31,780, 31,784. In the present litigation, each of these changes is challenged with some petitioners claiming that FERC went too far, and others contending that the Commission did not go far enough in asserting jurisdiction.
>
> A. *Bundled Retail Sales*
>
> Several state regulatory commissions complain that FERC exceeded the boundaries of its statutory authority by asserting jurisdiction over unbundled retail transmissions. . . .

225 F.3d at 691-92.

. . . .

> . . . . As for bundled retail sales, FERC's position is that once the transmission service is bundled with generation and local distribution, it becomes merely a component of the retail sale itself, over which FERC has no jurisdiction. . . .

Id. at 692.

. . . .

> . . . . FERC's decision to characterize bundled transmissions as part of retail sales subject to state jurisdiction therefore represents a statutorily permissible policy choice to which we must also defer under *Chevron*. Accordingly, we affirm FERC's decisions in Order 888 to assert jurisdiction over unbundled retail transmissions while leaving regulation of bundled retail transmissions to the states.

Id. at 694-95.

FERC Order No. 888 predates FERC Order No 2000.[1] The Staff notes again that in

[1] *Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services By Public Utilities; Recovery Of Stranded Costs By Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036, 61 Fed.Reg. 21,540 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996) ("Order 888"), *on reh'g*, Order No. 888—A, FERC Stats. & Regs. ¶ 31,048, 62 Fed.Reg. 12,274, *clarified*, 79 FERC ¶ 61,182 (1997), *on reh'g*, Order No. 888—B, 81 FERC ¶ 61,248, 62 Fed.Reg. 64,688 (1997), *on reh'g*, Order No. 888—C, 82 FERC ¶ 61,046 (1998).

FERC Order No. 2000, Statutes And Regulations, para. 31,089 at 31,213 (1999), in a subsection entitled "7. States' Roles with Regard to RTOs," the FERC acknowledges that the states are not preempted respecting authority for state commission approval of a utility joining an RTO:

> **We continue to believe that states have important roles to play in RTO matters. For example, most states must approve a utility joining an RTO,** and several states have required their utilities to turn over their transmission facilities to an independent transmission operator. . . .

[Emphasis added.].

The aforementioned cases clearly demonstrate, then, that this Commission is not preempted from deciding the instant case contrary to the position advocated by AmerenUE.

b. The Commission has not conceded that AmerenUE's withdrawal is in the public interest by failing to object to such a finding by the FERC.

AmerenUE argues in its initial brief at pages 23-24 that since the Commission was a party to the FERC proceeding which led to the FERC's May 8, 2001 Order accepting the March 20, 2001 Settlement Agreement between MISO and ARTO, the doctrines of estoppel and waiver prevent the Commission from acting in a manner inconsistent with the FERC's May 8, 2001 Order. The Staff sets out in detail in its initial brief the actions taken by the Commission to make clear that it was not joining in the Settlement Agreement, and was reserving its position for the proceeding that AmerenUE had agreed in the Stipulation and Agreement in Case No. EO-98-413 that it would initiate at the Commission, should AmerenUE seek to withdraw from the MISO.

AmerenUE cites *Drainage District No. 1 v. Matthews*, 234 S.W.2d 567 (Mo. 1950) and *MCI Metro Access Transmission Services v. City of St. Louis*, 941 S.W.2d 634 (Mo. App. 1997) which are inapposite, and fails to cite two other Missouri appellate court decisions involving allegations by utilities regulated by the Commission that the Commission was equitably estopped from taking certain ratemaking actions: *Missouri Gas Energy v. Public Service Comm'n*, 978

S.W.2d 434 (Mo.App. 1998) and *State ex rel. Capital City Water Co. v. Public Serv. Comm'n*, 850 S.W.2d 903, 910 (Mo.App. 1993).

Missouri Gas Energy involves appellate review of a decision of the Commission in a 1996 Missouri Gas Energy (MGE (a division of Southern Union Company)) rate increase case, Case No. GR-96-285. In that case, the Commission determined, according to the Western District Court of Appeals, that the carrying cost rates for an accounting authority order (AAO) granted in 1994 in *Re Missouri Gas Energy*, Accounting Authority Order, Case No. GO-94-234, 3 Mo.P.S.C.3d 201 (1994) should be, for ratemaking purposes, the weighted average short-term debt interest rate for allowance for funds used during construction (AFUDC) of 4% for 1994 and 6% for 1995 and 1996, instead of the 10.54% rate, which was requested by MGE in its Application for an AAO in Case No. GO-94-234 and authorized by the Commission in the AAO it issued in 1994. This 1994 AAO was preceded by several other AAOs, all for the same purpose of capitalizing and deferring recognition of certain costs respecting the utility's investment in new service lines and mains. This construction was occurring for the utility to comply with the Commission's gas line safety rules promulgated in 1989 in response to federal legislation. These two earlier AAOs had been granted in 1989 and 1992, in Case No. GO-90-51 and Case No. GO-92-185, respectively. 978 S.W.2d at 436-37.

MGE, among other things, made an equitable estoppel argument for continuation of the 10.54% carrying cost, asserting that the 1993 settlement and the 1994 AAO caused the equitable estoppel doctrine to be dispositive. The Western District Court of Appeals, noting that equitable estoppel is not ordinarily applicable to the government, identified the elements of equitable estoppel as follows, as it applies to a government entity:

> (1) a statement or act by the government entity inconsistent with the subsequent government act;

(2) the citizen relied on the act;

(3) injury to the citizen;

(4) the governmental conduct complained of must amount to affirmative misconduct;

(5) there must be exceptional circumstances and a manifest injustice will result;

(6) equitable estoppel will not be invoked if it will interfere with the proper discharge of governmental duties, curtail the exercise of the State's police power or thwart public policy; and

(7) equitable estoppel is limited to situations were public rights must yield because private parties have greater equitable rights.

978 S.W.2d at 439; *See State ex rel. Capital City Water Co. v. Public Serv. Comm'n*, 850 S.W.2d 903, 910 (Mo.App. 1993).[2] "The party claiming equitable estoppel has the burden of proof and every fact creating the estoppel must be established by clear and satisfactory evidence. *Van Kampen*, 685 S.W.2d at 625." 850 S.W.2d at 910. AmerenUE has not raised a claim which meets the criteria for the imposition of equitable estoppel.

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[2] "Equitable estoppel is normally not applicable against a governmental entity. *Farmers' & Laborers' v. Dir. of Revenue*, 742 S.W.2d 141, 143 (Mo. banc 1987). The application of equitable estoppel against governmental entities or public officers is limited to exceptional circumstances where right or justice or the prevention of manifest injustice requires its application. *Murrell v. Wolff*, 408 S.W.2d 842, 851 (Mo.1966); *State ex rel. Letz v. Riley*, 559 S.W.2d 631, 634 (Mo.App.1977). Honesty and fair dealing must require that equitable estoppel be applied in order to prevent manifest injustice. *Murrell*, 408 S.W.2d at 851. The doctrine is not favored by law and is not to be casually invoked. *State, Etc. v. City of Woodson Terrace*, 599 S.W.2d 529, 531 (Mo.App.1980). Equitable estoppel cannot be applied if it will prejudicially affect the sovereignty of the state. P.H. Vartanian, Annotation, *Applicability of Doctrine of Estoppel Against Government and its Governmental Agencies*, 1 A.L.R.2d 338, 340-41 (1948). As a result, equitable estoppel is not applicable if it will interfere with the proper discharge of governmental duties, curtail the exercise of the state's police power or thwart public policy. *Id.* at 341. The underlying principle behind its limited application to governmental entities and public officials is that public rights should yield only if private parties possess greater equitable rights. *Riley*, 559 S.W.2d at 634." 850 S.W.2d at 910.

Conclusion

WHEREFORE, for the reasons set forth above and in Staff's Initial Brief, filed October 29, 2001, the Staff recommends that the Commission assert its jurisdiction in this case. In the course of deciding this case, if the Commission wishes to base its decision: a) on the performance history of the Alliance Companies with regard to launching the ARTO in accordance with the directives and parameters articulated by the FERC, or b) on the fact that MISO is a not-for-profit entity and ARTO is for-profit, or c) on the likelihood that ARTO will be able to meet the FERC-established start-up date of December 15, 2001, the Staff would recommend denial of the Company's request for permission to withdraw from the MISO.

However, if the Commission chooses to base its decision on a determination that there is a likelihood that National Grid USA, or some similar managing member of ARTO, will be able to rectify the deficiencies in the current situation, then the Staff would recommend approval of the Company's request, subject to the series of conditions set forth in Section 2 of the Staff's Initial Brief.

Respectfully submitted,

DANA K. JOYCE
General Counsel

Dennis L. Frey

Dennis L. Frey
Associate General Counsel
Missouri Bar No. 44697
(573) 751-8700 (Telephone)
(573) 751-9285 (Fax)
e-mail: dfrey03@mail.state.mo.us

Steven Dottheim
Chief Deputy General Counsel
Missouri Bar No. 29149
(573) 751-7489 (Telephone)
(573) 751-9285 (Fax)
e-mail: sdotthei@mail.state.mo.us

Attorneys for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 7th day of November 2001.

Dennis L. Frey

Service List for
Case No. EO-2001-684
Verified: November 7, 2001 (ccl)

Office of the Public Counsel
P.O. Box 7800
Jefferson City, MO 65102

David B. Hennen
Ameren Services Company
1901 Chouteau
PO Box 66149 (MC 1310)
St. Louis, MO 63166-6149

Robin E. Fulton
Schnapp, Fulton, Fall, McNamara & Silvey
135 E. Main St., P.O. Box 151
Fredericktown, MO 63645-0151

Diana M. Vulysteke
Bryan Cave LLP
One Metropolitan Square
211 North Broadway, Suite 3600
St. Louis, MO 63102

Robert C. Johnson
Lisa C. Langeneckert
Law Office of Robert C. Johnson
720 Olive Street, Suite 2400
St. Louis, MO 63101

Duncan Kincheloe
Attorney at Law
2407 W. Ash
Columbia, MO 65203