BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

Staff of the Missouri Public Service Commission,	)	
Complainant,	)	
v.	)	Case No. EC-2009-0288
The Empire District Electric Company,	)	
Respondent.	)	

BRIEF OF THE MISSOURI ENERGY DEVELOPMENT ASSOCIATION AS *AMICUS CURIAE*

Summary of Complaint

On or about February 6, 2009, Staff filed a complaint against The Empire District Electric Company ("Empire") alleging that the sale by Empire of a portion of contracted fuel gas supply in early 2008 was in violation of Missouri law because Staff asserts the gas supply contracts were part of Empire's "works or system" as that phrase is used in § 393.190.1, RSMo. Consequently, Staff claims Empire should have first filed for and obtained the Commission's approval before entering into the sale transaction. Thereafter, on February 20, Empire filed a Motion to Dismiss the Complaint for Failure to State a Claim for which Relief can be Granted (the "Motion to Dismiss"). On February 26, Staff filed its Response to Empire's Motion to Dismiss coupled with a Motion for Determination on the Pleadings (the "Motion"). Staff's Motion is premised on the legal theory that the phrase "works or system" is applicable to the sale of fuel gas futures

contracts because the statutory prohibition encompasses the sale of all property of a utility, both real and personal, tangible and intangible. The phrase "works or system", Staff states, includes any personal property "being 'owned, operated, controlled, or managed in connection with or to facilitate' the utility purpose." *See*, Motion ¶ 12.

Empire's Motion to Dismiss

MEDA will not restate those matters already addressed in the Motion to Dismiss filed by Empire. MEDA concurs in Empire's assessment that the language in § 393.190.1, RSMo ["franchise, works or system"] is limited in scope to utilities' municipal franchise authorities and the hard, operational network assets of an electrical, gas or water utility that are employed in rendering service to customers. This practical, common sense interpretation of the statutory language is consistent with the purpose of the law, that is, "to insure the continuation of adequate service to the public served by the utility." *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo.App., E.D. 1980). The obvious legislative intent of § 393.190.1, RSMo is to impose regulatory control over a regulated utility's plant or system, the sale or transfer of which could cause a cessation, an interruption or an impairment of essential utility services. That the sale of the gas contract by Empire does not rise to this level is apparent from the fact that the transaction complained of took place a year ago in February of 2008, according to the Complaint, and there is no allegation on the part of Staff that Empire has not provided safe and adequate service to its customers during the intervening period of time.

An Instructive Indiana Supreme Court Ruling

While there are few Missouri cases on this point[1] (likely because the meaning of "works and system" is not in common usage), the meaning of those terms has been examined in the context of whether permission to dispose of a utility asset is required under a similar statute. For example, in *United States Gypsum, Inc. v. Indiana Gas Co., Inc.,* 735 N.E.2d 790, 801-02 (Ind. 2000), the Indiana Supreme Court held that a statute prohibiting utilities from selling, encumbering, etc. their "franchise, works or system" without Indiana Public Utilities Commission approval did not prohibit an Indiana gas utility from arranging for an entirely separate company to procure gas for the regulated utility. In so holding, the Indiana Supreme Court concluded that "franchise, works or system" means the "entire *operational* unity of a utility" (emphasis added). *Id.* at 801. Regulatory approval was not required because the utility (a) remained in control of their own physical gas delivery facilities, (b) remained gas providers in their service areas, (c) continued to review and approve supply plans, and (d) continued to operate their gas storage fields. *Id.* at 802.[2] Those same general considerations remain true as are pertinent to Empire's electrical business in that Empire remains in control of its transmission and distribution

[1] Staff cites none.

[2] In limiting "works and system" to physical assets involved in the delivery of service, the Indiana Supreme Court noted that "common definitions of 'works' include 'a factory, plant or similar building or complex of buildings where a specific type of business or industry is carried on' or 'internal mechanism: the works of a watch.' The American Heritage Dictionary of English Language 2056 (3d ed. 1996). * * * [and noted that] A system is '[a] group of interacting, interrelated, or interdependent elements forming a complete whole . . . functionally related groups of elements, expecially . . . a network of structures and channels, as for communication, travel or distribution. . . ..' The American Heritage Dictionary of English Language at 1823." A fuels contract fits neither of those definitions.

system, its power plants and plans to supply its power plants with fuel and any storage related to those fuels.

Past Commission Decisions

Staff's Complaint and its response to Empire's Motion to Dismiss both touch on the Commission's 1992 order in Case No. EO-92-250, a case that dealt with the sale by electric utilities of sulfur dioxide emission allowances. MEDA agrees with Empire that that decision has no precedential value inasmuch as the matter did not come before the Commission as a case or controversy. Accordingly, the decision is an unlawful advisory opinion.

Meaningful decisional guidance is available, however, in the form of a 1999 order in Case No. GR-96-181[3] in which the Commission by a 5-0 vote rejected an argument by Public Counsel that Laclede Gas Company needed the Commission's approval to sell to its off-system customers natural gas supplies to which it was entitled to call upon under contracts it had with its suppliers.[4]

> Public Counsel also argues that the Commission erred in not finding that Laclede made the sales at issue in violation of Section 393.190.1, and by not addressing its argument on this point in the Report and Order. This is the argument to which Laclede referred in its reply brief when it said: "With all due respect, it is difficult to imagine a more specious and unconvincing argument." The Commission did consider (and dismiss) this argument, but did not believe it required discussion in the Report and Order.

The Commission's *Laclede* decision is directly on point with the facts at issue in this case. It is apparent that the Commission in 1999 did not think much of the argument that Staff has now adopted. Staff certainly has offered no reason

[3] *In the Matter of Laclede Gas Company's Tariff Sheets to be Reviewed in its 1995-1996 Actual Cost Adjustment*.
[4] Order Denying Application for Rehearing, dated May 18, 1999. A copy of the entire text of the order is affixed hereto.

whatsoever why Commission should not once again dismiss the same, flawed argument.

Staff's Motion is Based on a Premise that Leads to Extreme And Illogical Results

MEDA is concerned about the practical and policy implications presented by Staff's Complaint against Empire. The Motion sets forth Staff's argument that the use of the term "personal property" in the definitions of the phrases "electric plant," "sewer system" and "water system" includes all personal property owned by a utility whether tangible or intangible. *See*, Motion, ¶ 6 and 11. Staff's theory leads to ridiculous and unworkable results which illustrate its obvious deficiencies. [5]

Staff's claim that all personal property owned by a utility is encompassed by the term "works or system" invites the obvious question of which personal property is not swept up in the regulatory net thus fashioned? Must a utility seek the Commission's approval to sell tangible assets that are used nearly every day in some aspect of routine operations like furniture, computers, lighting fixtures, vehicles, lawnmowers, telephone handsets, cameras or copy machines? It is difficult to believe that this was the bizarre result intended by the Missouri General Assembly when it enacted § 5651 in 1913 (now § 393.190).

Staff does not, however, limit its application of § 393.190.1, RSMo just to the sell of tangible personal property. The scope of the language, Staff argues,

[5] Preliminarily it should be noted that Staff's Complaint is premised on the assumption that the gas supply contract in question is an "asset" owned by Empire. This is a factual assumption that MEDA does not address herein, but the decision not to brief the question should not be construed as acceptance this notion by implication or otherwise.

extends to intangible personal property as well. Here, too, a few real world examples can be used to illustrate the unreasonable scope of this interpretation.

Fuel gas contracts such as those at issue in the Complaint are used as a hedge against price volatility. They are analogous to insurance contracts to manage risk, in this case, the risk of fuel cost fluctuations. What, then, are the regulatory implications that may attach to insurance against other common business risks? Are insurance contracts concerning business interruption, key man life insurance, director's and officer's liability, fiduciary liability, workers compensation, automobile or other customary commercial coverage also part of the utilities' works and system? What about other types of contractual arrangements such as for transportation services, office supplies, collective bargaining agreements, contract labor, engineering and design services, office leases, chemicals and myriad of other goods and services?

This short list of examples shows that Staff's interpretation of the phrase "works or system" is impossibly overbroad. The business of the Commission and the utilities it regulates would quickly grind to a halt if the sale or transfer of any personal property used by the industry needed first to be expressly okayed by the Commission. The scope of the statutory language must be circumscribed by a common sense application such as that has been provided by the Respondent in this case, Empire.

The Commission Cannot Manage the Public Utilities it Regulates

In addition to its deficiency as one that is overbroad in its application, Staff's theory of its case invites the Commission to exceed its statutory authority

by becoming involved in the day-to-day management of the utility's business. Stripped of its legal formalities, the Complaint is nothing more than an attempt by Staff to insert itself into the decision-making process undertaken by electric utilities in the development of their fuel procurement strategies.[6] Where this topic is concerned, the Commission should keep in mind that there is ample legal authority for the proposition that the Commission has no authority to manage the utilities it regulates and that any attempt to assume the role of both manager and regulator would create an untenable conflict of interest.

It is abundantly clear that the Commission's authority to regulate certain aspects of a public utility's operations and practices does not include the right to dictate the manner in which the company conducts its business. *State ex rel. City of St. Joseph v. Public Service Commission*, 30 S.W.2d 8 (Mo. banc 1930). The *City of St. Joseph* case involved an appeal by the City of St. Joseph, Missouri, of an order of the Commission affixing the value of property of St. Joseph Water Company for ratemaking purposes and approving a schedule of rates. In rejecting the applicant's contention that the Commission should not have authorized an administrative charge imposed on the operating company by its parent company, the Missouri Supreme Court stated the following:

> The holding company's ownership of the property includes the right to control and manage it, subject, of course, to state regulation through the Public Service Commission, but it must be kept in mind that the Commission's authority to regulate does not include the right to dictate the manner in which the company should conduct its business. The company has the lawful right to manage its own

[6] It bears special mention that there is no requirement under law or rule that an electric utility in this state hedge any portion of its fuel costs in the first instance so it is difficult to fathom how a purely discretionary undertaking can become so integral to operations so as to require the Commission's permission to unravel.

> affairs and to conduct its business in any way it may choose, provided that in doing so, it does not injuriously affect the public. The customers of a public utility have the right to demand efficient service at a reasonable rate, but they have no right to dictate the methods which the company must employ in that rendition of that service. It is of no concern of either the customers of the water company or the Commission, if the water company obtains necessary material, labor, supplies, etc., from the holding company so long as the quality and price of the service rendered by the water company or what the law says it should be.

Id. at 14.

The concept that the Commission is not empowered to manage the business activities of the utilities it regulates has also been recognized by the Commission itself in a context that is very similar to the one under consideration here. With the emergence of open access transportation at the federal level in the late 1980's and early 1990's, local distribution companies suddenly had the obligation to procure gas supplies from a wide variety sources. In view of this development, the Commission opened up a docket to examine what revisions to its regulatory policies were necessary, including whether it should or even could assert greater control over how local distribution companies acquire such supplies. In determining that such involvement in the gas procurement function was not appropriate, the Commission stated that a "company's choice of the appropriate mix of gas to procure is a management decision and is properly left to the company." *In the matter of developments in the transportation of natural gas and their relevance to the regulation of natural gas corporations in Missouri,* 29 Mo.P.S.C (N.S.) 137, 143 (1987). The same considerations that led the Commission to determine more than

twenty years ago that it should not attempt to exercise control over how management acquires physical gas supplies are equally pertinent to decisions regarding how to hedge the cost of such supplies.

In short, the Commission's powers are "purely regulatory in nature." *State ex rel. Harline v. Public Service Commission*, 343 S.W.2d 177, 181 (Mo.App., W.D. 1960). It does not have the "authority to take over the general management of any utility." *State ex rel. Laclede Gas Company v. Public Service Commission,* 600 S.W.2d 222, 228 (1980). The *Harline* court was emphatic concerning this principle.

> The utility's ownership of its business and property includes the right to control and management, subject, necessarily to state regulation through the Public Service Commission. The powers of regulation delegated to the Commission are comprehensive and extend to every conceivable source of corporate malfeasance. Those powers do not, however, clothe the Commission with the general power of management incident to ownership. The utility retains the lawful right to manage its affairs and conduct its business as it may choose, as long as it performs its legal duty, complies with lawful regulation and does no harm to the public welfare.

Id. It is clear that the Commission may regulate a public utility's operations as the law expressly permits but it may not substitute its business judgment for that of the company's management so long as safe and adequate service is being provided.

The ultimate hazard for the Commission is readily apparent. If it were to purport to exercise a veto power over the business practices of the company it regulates, it would be bound in subsequent rate cases by the decisions it made about those same business and management practices. This conundrum is one

that the Commission has already confronted. In previous legal proceedings, the Commission stated to the Southern District Court of Appeals that it would be a conflict of interest for the Commission to assume the dual role of manager and regulator. According to the Commission, a circuit court order appointing the Commission as receiver for a sewer company would put the Commission "in the conflicting position of regulator and regulated". *State ex rel. Public Service Commission v. Bonacker*, 906 S.W.2d 896, 899 (Mo.App. 1995).

Staff's attempt to use the vehicle of a complaint to insert itself and the Commission into the fuel procurement practices of an electric utility has as its ultimate objective the goal of hijacking one of the key prerogatives reserved to the informed discretion of an electric utility's management. This is not only unlawful, but poor public policy as well. The denial of Staff's Motion will maintain the careful and necessary balance between the managerial powers of the utility and the regulatory powers of the Commission.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was delivered by first class mail, electronic mail or hand delivery, on the 6th day of March, 2009, to the following:

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STATE OF MISSOURI

PUBLIC SERVICE COMMISSION

At a Session of the Public Service

Commission held at its office

in Jefferson City on the 18th day of May, 1999.

In the Matter of Laclede Gas Company's)

Tariff Sheets to be Reviewed in its) **Case No. GR-96-181**

1995-1996 Actual Cost Adjustment.)

ORDER DENYING APPLICATION FOR REHEARING

This case was created to review the actual gas costs of Laclede Gas Company (Laclede) during the 1995-1996 Actual Cost Adjustment (ACA) period for the purpose of establishing Laclede's ACA factor. Upon its examination of the costs and revenues during that period, the Staff of the Commission (Staff) recommended that Laclede's ACA balance be adjusted by including $3,569,843 in additional revenue from the proceeds from off-system sales of gas. Staff proposed no other adjustments; the Office of the Public Counsel (Public Counsel) supported this adjustment and Laclede opposed it.

On April 20, 1999, the Commission issued its Report and Order in which it determined that Laclede had properly accounted for the revenues from the off-system sales, and declined to adopt Staff's proposed adjustment. On April 29, 1999, Public Counsel timely filed an Application for Rehearing. Public Counsel asserts that the Commission's Report and Order is unlawful, unjust, unreasonable,

arbitrary and capricious, unsupported by competent and substantial evidence, and lacks adequate findings of fact.

Public Counsel alleges that the evidence does not support the finding that Laclede purchased gas to resell off-system, but instead shows that Laclede "purchased the gas at issue to serve its native load customers based upon its system design." Public Counsel appears to misunderstand the distinction between contracting for the right to purchase gas and actually purchasing gas. Laclede prudently entered into supply contracts to serve its customers. It turned out that Laclede had the right under these contracts to purchase more gas than it needed to serve all of its customers' needs. Laclede therefore actually purchased some of the gas to which it had rights under the contracts at attractive prices so that it could resell it at a profit to entities other than its customers. As discussed below in reference to Laclede's response, there is ample evidence to support this finding.

Public Counsel also asserts that the Commission erred in not treating the revenues from the off-system sales as a capital gain, and thus subject to the analysis the Commission "historically has conducted to determine the proper treatment of utilities' capital gains from the sale of an asset." The Commission is not bound by any particular method of determining rates, and need not conduct a particular type of analysis in this case even if it had done so in the past in similar cases. Furthermore, Public Counsel's argument that the revenue from the sales of gas must be analyzed in the same way as the profit from the sales of real property is not persuasive.

Public Counsel also argues that the Commission erred in not finding that Laclede made the sales at issue in violation of Section 393.190.1, and by not addressing its argument on this point in the Report and Order. This is the argument to which Laclede referred in its reply brief when it said: "With all due respect, it is difficult to imagine a more specious and unconvincing argument." The Commission did consider (and dismiss) this argument, but did not believe it required discussion in the Report and Order.

Public Counsel's final point simply restates its argument that Laclede's then-effective tariff language required PGA/ACA treatment of the off-system sales revenues. The

Commission has fully considered and addressed this point, and finds no basis to grant rehearing on it.

On May 10, 1999, Laclede filed a response opposing Public Counsel's application for rehearing. Laclede states that Public Counsel's application raises legal and factual contentions that have already been considered and rejected by the Commission. Laclede also notes that there is evidentiary support for the Commission's finding, challenged by Public Counsel, that Laclede was able to purchase gas for the express purpose of reselling it at a profit. Laclede points out several instances in which this finding is supported by the record. The Commission notes that there is at least one more: Laclede witness Neises' responses to questions from the bench as reflected at pages 127-128 of the transcript.

Pursuant to Section 386.500, RSMo 1994, the Commission shall grant a rehearing if it finds sufficient reason to do so. Public Counsel's Application for Rehearing does not provide sufficient reason, and so the Commission will deny the Application for Rehearing.

IT IS THEREFORE ORDERED:

1. That the Application for Rehearing, filed on April 29, 1999, by the Office of the Public Counsel, is denied.

2. That this order shall become effective on May 18, 1999.

BY THE COMMISSION

Dale Hardy Roberts

Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Crumpton, Murray,

Schemenauer, and Drainer, CC., concur

Mills, Deputy Chief Regulatory Law Judge