States, 292 U.S. 571, 579 (1934) ("valid contracts are property, whether the obligor be a private individual, a municipality, a state or the United States.").

Even where government representations of promises do not technically rise to the level of contract, they nevertheless may induce private action and investment in reliance on them. When the government has thus induced reasonable, investment-backed expectations that the government will act in some manner, a subsequent change in government policy - no matter how meritorious - that defeats these expectations renders the government liable for just compensation to those who held them. See, e.g., Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1011 (1984); Kaiser Aetna v. United States, 444 U.S. 164, 179 (1979). Thus, even if the regulatory compact did not exist as a matter of law, the same extensive relationship between utilities and Missouri described above also establishes the basis for reasonable, investment-backed expectation, induced by government representations, that they would have a fair opportunity to recover its full economic costs of providing service to the public. Such expectations cannot be infringed without just compensation from the State.

In addition to breaching the regulatory compact and frustrating utilities "reasonable investment-backed expectations," mandatory access required by retail wheeling also constitutes a *per se* taking under Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982). As the Supreme Court stated in that case, "[w]hen faced with a constitutional challenge to a permanent physical occupation of real property, this Court has invariably found a taking." Id., at 427. Retail wheeling is characterized by mandatory transmission across the incumbent's network, and thus, falls within the Supreme Court's definition of a "permanent physical occupation." A competitor supplying power to an incumbent's customers physically occupies the utility's transmission and distribution facilities. Thus, the utility would be entitled to just compensation for the reduction in value of their overall property, where a partial *per se* taking has occurred. See, e.g., United States v. Grizzard, 219 U.S. 180, 183 (1911)("[w]henever there has been an actual physical taking of part of a distinct tract of land, the compensation to be awarded includes not only the market value of that part of the tract appropriated, but the damages to the remainder resulting from that taking, embracing, of course, injury due to the use to which the part appropriated is to be devoted"). In calculating such damages, courts award the difference between the overall value of the property before and after the taking. See, Id. at 185; United States v. 14.38 Acres of Land, 80 F.3d. 1074, 1077 (5th Cir. 1996).

With respect to retail wheeling (whether accomplished through open access or through a pooling arrangement), the utility's "before and after" damages will by definition encompass the total diminution in the value of its property resulting from the *per se* takings. Such damages will include, *inter alia*, the generating costs that would be stranded as a result of the imposition of a retail wheeling regime.

Even if the existing regulatory arrangement is not seen as giving rise to contractual obligations or investment-backed expectations, the Fifth Amendment has long been understood to restrict the discretion of state legislators and regulators in utility ratemaking, at the very least establishing a floor below which rates may not be set. See, e.g., Bluefield Waterworks & Improvement Co. v. Public Service Comm'n, 262 U.S. 679, 692 (1923) ("A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other businesses undertakings which are attended by corresponding risks and uncertainties."). A shift to competition that failed to provide for the recovery of investments made under the prior regulatory regime would result in confiscatory rates, thereby triggering the State's obligation to provide Just Compensation. See, e.g., Duquesne Light Co. v. Barasch, 488 U.S. 299, 315 (1989) (noting that "serious constitutional questions" would be created if a state switched methodologies "in a way which required investors to bear the risk of bad investments at some times while denying the them the benefits of good investments at others").

Proponents of full recovery point to the Federal Energy Regulatory Commission (FERC) in its order initiating open access in the wholesale transmission of electric power considered the recoverability of stranded costs and concluded: "[W]e believe that the utility is *entitled* to recover legitimate, prudent and verifiable costs that were incurred under the prior regulatory regime to serve that customer." Order No. 888, 61 Fed. Reg. 21540, 21,630 (May 10, 1996) (emphasis supplied). Yet this had not always been FERC's position on the question of strandable costs in the competitive transformation of a network industry. FERC's description of how it was educated by the federal court bears quoting at some length here:

> We learned from our experience with natural gas that, as both a legal and a policy matter, we cannot ignore these costs. During the 1980's and early 1990's, the Commission undertook a series of actions that contributed to the impetus for

> restructuring of the gas pipeline industry. The introduction of competitive forces in the natural gas supply market as a result of the Natural Gas Policy Act of 1978 and the subsequent restructuring of the natural gas industry left many pipelines holding uneconomic take-or-pay contracts with gas producers. When the Commission initially declined to take direct action to alleviate that burden, the U.S. Court of Appeals for the District of Columbia Circuit faulted the Commission for failing to do so. The court noted that the pipelines were "caught in an unusual transition" as a result of regulatory changes beyond their control.
>
> [T]he court's reasoning in the gas context applies to the current move to a competitive bulk power industry. Indeed, because the Commission failed to deal with the take-or-pay situation in the gas context, the court invalidated the Commission's first open access rule for gas pipelines. Once again, we are faced with an industry transition in which there is the possibility that certain utilities will be left with large unrecoverable costs or that those costs will be unfairly shifted to the other (remaining) customers. That is why we must directly and timely address the costs of the transition by allowing utilities to seek recovery of legitimate, prudent and verifiable stranded costs.

Id. (citing Associated Gas Distrib. v. FERC, 824 F.2d 981, 1021, 1027 (D.C. Cir. 1987)).

Failure to compensate utilities for stranded costs impairs the State's obligation under the regulatory contract in violation of the Contract Clause. Accordingly, affected utilities could seek to have any state statute stranding costs declared unconstitutional and have its enforcement enjoined. See, e.g., New Orleans Gas-Light Co. v. Heat Producing & Mfg., 115 U.S. 650 (1885); New Orleans Water-Works Co. v. Rivers, 115 U.S. 674 (1885); City of Walla Walla v. Walla Walla Water Co., 172 U.S. 1 (1898); Russell v. Sebastian, 233 U.S. 195 (1914); Detroit v. Detroit Citizen's Street Ry. Co., 184 U.S. 368 (1902); and, Cleveland v. Cleveland City Ry., 194 U.S. 517 (1904). If legislation is passed which deprives a utility of a reasonable opportunity to fully recover its stranded costs is enacted, the utility would have the right to file suit to enforce its rights under the Just Compensation and Contract Clauses of the Constitution. Under the former, utilities would be entitled to recover the fair market value of the property taken, in an amount that will by any calculation be hundreds of millions, if not billions, of dollars. Most importantly, while such legislation would effect a forced transfer of income from utilities and their investors to potential competitors and/or ratepayers, it would not be those so benefitted that would be called to account. Rather, it would be the State Treasury - ultimately the taxpayers - that would be called to account. The consequences flowing from a violation of rights under the Contract Clause may be nearly as severe. Utilities may be entitled to a declaratory judgment and injunctive relief striking down the legislation - thereby halting in its tracks the General Assembly's effort to restructure the retail electric industry in Missouri.

This is not to assert a right to perpetually maintain the present regulatory structure. However, the transition from the old to the new must provide for full recoupment of the prudent investments made under the *ancien regime*. This is not only the law; it is the right thing to do. As Justice Hugo Black once observed, "It is no less good morals and good law that the Government should turn square corners in dealing with the people than that the people should turn square corners in dealing with their Government." St. Regis Paper Co. v. United States, 368 U.S. 208, 229 (1961) (Black, J., dissenting) (quoted with approval in Heckler v. Community Health Services, 467 U.S. 51, 61 n.13 (1984)).

As noted by the President's Council of Economic Advisers:

> [T]here is an important difference between regulated and unregulated markets. Unregulated firms bear the risk of stranded costs but are entitled to high profits if things go unexpectedly well. In contrast, utilities have been limited to regulated rates, intended to yield no more than a fair return on their investments. If competition were unexpectedly allowed, utilities would be exposed to low returns without having had the chance to reap the full expected returns in good times, thus denying them the return promised to induce the initial investment. A strong case therefore can be made for allowing utilities to recover stranded costs where those costs arise from after-the-fact mistakes or changes in regulatory philosophy toward competition, as long as the investments were initially authorized by regulators.
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> ****
>
> [R]ecovery should be allowed for legitimate stranded costs. The equity reason for doing so is clear, but there is also a strong efficiency reason for honoring regulator's promises. Credible government is key to a successful market economy, because it is so important for encouraging long-term investments. Although policy reforms inevitably impose losses on some holders of existing assets, good policy tries to mitigate such losses for investments made based on earlier rules.

Council of Economic Advisors, 1996 ECONOMIC REPORT OF THE PRESIDENT at 187 (GPO 1996).

B. Arguments and Authority Limiting Recovery of Stranded Costs

1. Introduction

Opponents of stranded cost recovery note that those favoring stranded cost recovery generally argue that a right to such recovery stems from the Takings Clause of the Fifth Amendment of the United States Constitution (also known as the Just Compensation Clause). The Takings Clause prohibits the government from taking private property for public use without just compensation. Under the Fourteenth Amendment, the Takings Clause applies to states. Determining whether a taking has occurred is a fact-specific inquiry, based on three factors set forth in Penn Central Transportation Co. v. New York City, 438 U.S. 104 (1978). These three factors are: 1) the regulation's "economic impact" on the property owner; 2) the extent to which the regulation interferes with "distinct investment-backed expectations;" and 3) the character of the interference, that is, whether the governmental action is more akin to a physical invasion or to a necessary readjustment of economic benefits and burdens.

In construing these factors, opponents assert that the Supreme Court has "eschewed the development of any set formula" for determining which property-right infringements constitute compensable takings, relying "instead on ad hoc, factual inquiries into the circumstances of each particular case." Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 224 (1986). The Supreme Court has addressed takings in three categories: physical invasions of property ("physical takings"), regulatory takings and confiscatory ratemaking. Those favoring stranded cost recovery generally argue that restructuring the electric utility industry to inject more competition would result in a taking under each of these analyses. Such a taking, they claim, would arise from: 1) the use of utility distribution lines by others; and 2) the violation of the so-called regulatory compact. As discussed below, opponents assert, none of the market structures currently being examined (and probably no others that would receive any serious consideration) would result in a taking.

2. Regulatory Taking

Those favoring stranded cost recovery also claim that restructuring would result in a regulatory taking that gives rise to an alleged right to recovery of stranded costs. This claim is founded on the so-called regulatory compact. The costs that may become stranded are now being recovered in the rates charged by the electric utilities. The claim is that denial of full recovery of, and on, the investments during restructuring would be a regulatory taking. The Penn Central standard for regulatory takings considers: 1) the character of the government action; 2) the economic impact of the change in regulation on the claimant; and 3) the extent to which the regulation has interfered with distinct investment-backed expectations. Penn Central, *supra*. The first element, the character of the government action, focuses on whether the government action is more like a physical invasion, or a necessary readjustment of economic benefits and burdens. The government action in the proposed restructuring of the electric industry would make the supply of generation competitive and, in two of the market structures, open service territories to competitors. Almost by definition, if the Legislature acts to allow a restructuring of the electric industry, it will be because it believes such action is a necessary readjustment of economic benefits and burdens, not a physical taking. Andrus v. Allard, 444 U.S. 51, 65 (1979), dealt with legislation that prohibited the sale of lawfully-acquired eagle feathers and found that even though that legislation eliminated the most valuable property right, it was not dispositive on taking. The Court noted that:

> [G]overnment regulation by definition involves the adjustment of rights for the public good. Often this adjustment curtails some potential for the use or economic exploitation of private property.

> At any rate, loss of future profits unaccompanied by any physical property restriction provides a slender reed upon which to rest a takings claim. Prediction of profitability is essentially a matter of reasoned speculation that courts are not especially competent to perform. Further, perhaps because of its very uncertainty, the interest in anticipated gains has traditionally been less compelling than other property-related interests. [citations omitted.] *Id.*, at 65-66.

The Court has found a taking based solely on economic impact (the second element of the Penn Central test) only where regulation destroys not just limits or curtails - any economic use of the property. See Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992). However, a reduction in the value of property because of regulation is not necessarily a taking, even when the reduction in value may be significant (no taking found in Euclid v. Ambler Realty Co., 272 US 365 (1926) when there was a 75% diminution in value, or in Hadachek v. Sebastion, 239 US 394 (1915) when there was a 92.5% diminution in value).

The third and final element of a regulatory takings analysis under the Penn Central test is the interference of a regulation with distinct investor expectations. The basis of the investor expectations, the extent of regulation of the industry, the explicit allocation of risk of regulatory change, and the reasonableness of the expectations are all factors that the courts have taken into consideration under this element of the test. Those favoring stranded cost recovery allege that electric utilities have invested in plant with the expectation that this investment would be recovered in rates. However, this allegation is not sufficient to create an interest protected under the Takings Clause, given the risks of regulatory, even when this change adjusts the burdens and benefits of regulations.

3. Physical Taking

Opponents note that a physical taking occurs when ones private property is physically intruded upon by governmental action, either for its own use or for a third party's. In Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 426 (1982), the Supreme Court stated "[a] permanent physical occupation authorized by government is a taking without regard to the public interests that it may serve." In Loretto, a New York statute required landlords to permit cable installations for their tenants at rates set by a state commission. The Court held that the presence of the cable was a permanent physical occupation of the owner's property and established the rule that a permanent physical occupation of private property, however minimal, results in a *per se* taking which is compensable. While the Loretto court referenced the three-part Penn Central test of a regulatory taking, it stated that a permanent physical occupation is a taking without regard to the other factors in the analysis, including the public interests served. *Id.*, at 426-435. The Court distinguished between a permanent physical occupation, a physical invasion short of an occupation, and a regulation that restricts the use of property; the latter two are subject to the Penn Central balancing test. *Id.*, at 430-432.

According to Loretto, a permanent physical absolutely dispossesses the owner of the rights to use and exclude others from the property. *Id.*, at 435. Those favoring stranded cost recovery generally argue that access to distribution wires amounts to a permanent physical occupation (requiring compensation) of private property because electric utilities would be required to allow competitors to occupy a portion of the wires with their power. This claim fails because access to distribution wires does not destroy the electric utilities rights to possess, use and dispose of the wires. Electric utilities would still retain the ability to use and control the wires; at most, others' use of the wires would be transitory, and there would be no permanent physical occupation such as the cable installation in

Loretto. Moreover, electric companies would derive fair compensation for use pursuant to federal and state rates for transmission and distribution.

Confiscatory Ratemaking

The third line of Takings Clause cases cited by those favoring stranded cost recovery deal with confiscatory ratemaking. These cases are generally agreed to stem from Hope and Bluefield (FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944) and Bluefield Water Works &Improvement Co. v. PSC, 262 U.S. 679 (1923)). Rates for regulated electric utilities must be designed to raise revenue that is sufficient to recover their costs, raise capital necessary to the discharge of their public duties, and otherwise assure confidence in the financial integrity of the enterprise. The confiscatory ratemaking theory is that if high cost utilities realize stranded costs, and stranded cost recovery is not allowed, utility property would be confiscated by government action since these high cost utilities would not be guaranteed a return on that property. As noted in Permian Basin Area Rate Cases, 390 U.S. 747 (1968):

> No constitutional objection arises from the imposition of maximum prices [the complained-of regulatory change] merely because high cost operators may be more seriously affected .. . than others, Bowles v. Willingham, [321 US 503 (1944), at 518], or because the value of regulated property is reduced as a consequence of regulation [Hope, *supra*]. Regulation may, consistently with the Constitution, limit stringently the return recovered on investment, for investors interests provide only one of the variables in the constitutional calculus of reasonableness. [citations omitted]. *Id.*, at 435.

In Market Street Railway Co. v. Railroad Commission of California, 324 U.S. 548(1945), the Court stated: The due process clause has been applied to prevent governmental destruction of existing economic values. It has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces. *Id.*, at 567. The Hope and Bluefield line of cases stand for the simple proposition that the overall impact of ratemaking is the test of reasonableness, not all of the subsidiary aspects of valuation (Duquesne Light Company v. Barasch, 488 U.S. 299 (1989)). They do not require a utility to be compensated for each particular piece of property. As noted by the Hope court, [r]ates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return. (Hope, *supra*, at 605). Noticeably absent in the arguments of those favoring stranded cost recovery is any proof that lack of such recovery will seriously threaten the financial integrity of electric utilities.

LEGAL IMPEDIMENTS

INTRODUCTION

The Legal Committee took on the task of identifying existing legal impediments to the implementation of retail electric competition in Missouri. While some of these impediments identified will require either definitional or other statutory changes to Missouri law, others could be addressed through judicial construction of statutes in a manner not inconsistent with competition. An impediment was generally defined as being a specific aspect of state law that, in its present form, might be construed to prevent or frustrate the implementation of retail electric competition in Missouri. Existing judicial construction was reviewed, but in most instances is on other points of these statutes and is of limited interpretive assistance as regards retail competition issues.

While some possible legislative solutions have been indicated in the following discussion, the committee viewed the preparation of drafted legislation as being beyond both the scope of its assignment and time availability.

Finally, this report has been prepared under certain assumptions regarding the general "shape" of restructuring proposals as well as the Stranded Cost Task Force Working Group Report and the general outlines of the Market Structure Working Group Report. Major departures from those assumptions would require a renewed review of these or other provisions.

I. DISCUSSION OF IMPEDIMENTS.

A. Limitation on Types of Entities and Operations.

Under Missouri's current statutory formulation only three somewhat broadly defined types of entities are permitted to engage in the business of supplying electric energy at retail, electrical corporations under Chapter 386, rural electric cooperatives under Chapter 394, and municipally owned utilities under Chapter 91 and various other charter and statutory provisions.

At the very outset, this creates an impediment to a competitive market because any new entity would have to fit itself into the box described by one of the three statutory chapters with all of the historical limitations that each industry segment was required to meet. Either broader descriptions of the existing entities or new types of entities or both must be provided.

B. Statutory Assumption of Integration of Operations.

As discussed in greater detail herein, current Missouri statutes contemplate the supply of electricity as an integrated enterprise consisting of all facets of the electric business from generation to distribution and every function in between. Each of the Chapters of Missouri Statutes that regulate a segment of the electric industry in Missouri assume an integrated electric supply enterprise. Accordingly, the language describing the authority of each type of entity is couched in operating electric light and power plants -- which definition apparently includes transmission and distribution facilities -- or in being an electric supplier -- which encompasses everything from generation through final distribution and metering.

In broad generality, this approach and statutory concept will have to be modified to redefine the service of electricity into its functional components. Failure to do this could force providers of competitive services to attempt to meet arcane rules designed for the historic operational environment and not for an environment designed to increase competition in the provision of those services.

C. Missouri's "anti-flip/flop" Statutes, Sections 393.106, 394.315 and 91.025 RSMo 1994.

Sections 393.106 and 394.315 were added to Missouri law in 1982 and were amended in 1986 and more substantially in 1991 when Section 91.025 was added. They provide protection against a customer switching between suppliers for economic reasons, in other words, for a better rate. Section 393.106 gives protection to an investor-owned utility, Section 394.315 applies to a cooperative and Section 91.025 applies to municipal systems.

In essence, these sections provide that, once either an IOU, cooperative or municipal electric utility has begun providing service of "retail electric energy" to a structure through permanent facilities, they have the right to continue doing so. Pursuant to an application for change of electrical suppliers, the Commission is given authorization to approve a change that is in the public interest for some reason other than a "rate differential." No such right is acquired if the service is "temporary." The wording of the statute is also plain in that the existing utility is given the "right" to continue service to the subject structure, and third parties are denied any "right" to service that structure. In all three cases, the language chosen by the legislature is non-prohibitory and thus the clear implication is that an existing utility could agree to waive its right to continue service in an appropriate case and thereby permit another utility to accept the customer.

Certain terms such as "structure" and "temporary service" are defined in the statute. A term that is critical for purposes of this review, "supplier," is not defined.

The rationale for the statute is transparent. A requirement is the construction of permanent facilities to provide service to a structure. If the customer were permitted to switch to another utility without restraint, this switch could affect the ability of the first utility to recover on any investment made.

Following that rationale, direct access would present no necessity for statutory modification, so long as the existing facilities installed to provide service to a structure would continue to be used to deliver energy to that structure and such delivery would be compensated. If, however, the term "supplier" is defined to include the entity that sells the electrical energy to the structure, then statutory modification is almost certainly necessary.

The Commission has adopted the latter interpretation. In In re Empire District Electric Company, EO-97-491, the Commission was presented with a proposed experimental direct access pilot program that had been agreed to by the utility and two of its larger customers. The proposal would have permitted these two customers to arrange purchase of capacity and energy from third parties, but each would have continued to receive delivery of those supplies through Empire District's installed facilities, with each paying the Commission-established rate for that delivery service. The arrangement was presented as having been designed to make Empire "whole". Any potential benefit to the two customers was asserted to come through being able to purchase energy in the direct access market at energy costs that would have been below the costs that Empire would have incurred to generate the energy. Even though in that case the existing utility agreed that there was no change of supplier, other parties contended that the proposal constituted an unlawful change of suppliers. The Commission rejected the experimental arrangement, stating as follows:

> The proposed tariffs violate the provisions of Section 393.106, RSMo 1996. The Empire District Electric Company is the lawful supplier of retail electric energy to ICI and Praxair through permanent service facilities and, therefore, other suppliers of electrical energy are expressly denied the right to provide such service in the form of sale of electric power directly to these customers.
>
> The proposed tariffs are therefore rejected.

This holding from the Commission makes statutory modification (or possible judicial clarification) of these statutes necessary. One mechanism could be through definition of the term "supplier." The existing direct access proposals do not appear to contemplate that a customer would receive service other than through existing facilities; they would simply permit a customer to purchase energy from a third party, but continue to have that energy delivered to their "structure" through the facilities of the existing "supplier." This mechanism would still leave the prohibition of a change in supplier for reason of a rate differential.

Another mechanism would be to remove the term "supplier" from these statutes and rewrite them to focus the protection of the statute on a change in the delivery facilities themselves. This mechanism also would leave in place the prohibition of a change in supplier for reason of a rate differential.

D. Definitional Sections Relating to Missouri Public Service Commission Jurisdiction.

Review of the definition sections of Missouri statutes that govern the Missouri Public Service Commission and electric public utilities indicates that there are several modifications that would need to be made to these statutes for electric competition to work in Missouri.

All public utilities in Missouri are subject to the jurisdiction, control and regulation of the Commission. Section 386.020(42). The term "public utility" includes every electrical corporation as defined in 386.020(15). An "electrical corporation" is defined as:

> [E]very corporation, company, association, joint stock company or association, partnership and person, their lessees, trustees or receivers appointed by any court whatsoever . . . owning, operating, controlling or managing any **electric plant** except where electricity is generated or distributed by the producer solely on or through private property for railroad, light rail or street railroad purposes or for its own use or the use of its tenants and not for sale to others.

Section 386.020(15) RSMo. (Emphasis added). The term "electric plant" is defined as follows:

> [A]ll real estate, fixtures and personal property operated, controlled, owned, used or to be used for or in connection with or to facilitate the generation, transmission, distribution, sale or furnishing of electricity for light, heat or power; and any conduits, ducts or other devices, materials, apparatus or property for containing, holding or carrying conductors used or to be used for the transmission of electricity for light, heat or power.

Section 386.020(14).

Under these definitions, a public utility includes any entity owning, operating, managing or controlling any property to be used in connection with transmission, distribution or sale of electricity. Accordingly, any entity seeking to compete in the market for electricity in Missouri would be considered a public utility subject to full regulation by the Commission.

Full public utility regulation for every such entity would be an impediment to competition. In order for competition to be practical, exceptions to the definitions discussed above would have to be created so that it would be possible for an entity, with or without its own generating facilities, to use, operate, control or own transmission and distribution assets for the sale of electricity in Missouri, without related generating facilities or the output of related generating facilities being subject to public utility regulation. However, some regulation of non-public utility providers would be needed. It seems that a definition of "competitive retail electricity provider" to include entities selling energy or capacity to consumers (subject to some regulation by the Commission such as licensing and the filing of financial documents) would remove the impediments created by the present definitions.

E. Territorial Agreements and Commission Regulation.

1. General Comments.

Under current statutes each segment of the electric industry (investor owned utilities, municipal utilities and rural electric cooperatives) faces geographic limits in the areas they are permitted to serve. Municipally owned utilities are limited by Section 386.800 RSMo. to serving within their city limits. Rural electric cooperatives find a limit in Section 394.080 RSMo to serving in rural areas, which are defined by Section 394.070 RSMo to be any area not within the boundaries of a city, town or village with a population in excess of 1,500 inhabitants.

Under the supervision of electrical corporations by the Public Service Commission, pursuant to Section 393.170, electrical corporations are limited to serving were they are authorized by Commission certificate. Certificates of convenience and necessity are granted to electrical corporations on a geographic area or a line basis. Electrical corporations are authorized to serve within the metes and bounds described in their area certificates or from a reasonable extension from a line authorized by a line certificate.

There may be need for these territorial limiting sections to be modified to accommodate existing and new competitors if a realistic competitive market is to develop.

2. Territorial Agreements and Related Provisions.

Chapter 394 generally deals with the creation and regulation of electrical cooperatives.

Section 394.312 provides for written territorial agreements between rural electric cooperatives, electrical corporations and municipally-owned utilities under which the boundaries of the electric service area of each electric service supplier is designated. Section 394.312 addresses territorial agreements between electric service suppliers, but is not by its terms limited to cooperatives. Subsection 1 of this section provides that competition may be displaced by written agreements between suppliers, but only as provided for in this section. Subsection 2 requires that territorial agreements designate territorial boundaries between suppliers. If the suppliers cannot agree, the Commission may designate such boundaries.

This section, however, appears to take precedence in certain circumstances to what might otherwise become prior rights under the "anti-flip/flop statutes, Sections 393.106 and 394.315. Said another way, a supplier could not use service provided under a territorial agreement to gain prior rights under the anti-flip/flop statutes unless that agreement had been approved by the Commission.

Essentially, the same definition problem exists in this section as noted with the anti-flip/flop statutes. The term "supplier" is not defined. It is therefore suggested that a definition for "supplier" would need to be added to clarify any legislative intention regarding the applicability of this section to third party providers of only energy or capacity who will still be delivering electricity through the transmission and distribution facilities of the electricity supplier to whose system the customer is directly attached.

3. Other Territorial Restrictions or Expansions.

Section 386.800 grants municipally-owned utilities the right to provide service at retail to structures outside the boundaries of the municipal corporation under certain circumstances with certain exceptions. It also authorizes the Commission to assign exclusive service territories within annexed areas and to determine fair and reasonable compensation to be paid for facilities acquired.

Insofar as direct territorial restrictions are concerned, Section 394.080(4) authorizes rural electric cooperatives to provide service in non-rural areas as defined in the statute. Additionally, Section 394.080 limits rural electric cooperatives to serving their members, governmental entities, and other persons not exceeding ten percent of their membership. By itself, this could be an impediment to electric cooperatives operating in a competitive market because some customers would be ineligible to buy from cooperatives limiting competition by limiting the choice of suppliers.

F. Individual Statutes Pertaining to Municipals, Co-ops and Investor Owned Utilities.

1. Section 386.020(15).

The Section 386.020(15) definition of "electrical corporation" subjects to the jurisdiction of the Missouri Public Service Commission any entity which owns, operates, controls or manages any electric plant and holds itself out to sell electricity to the public. Some of the definitional problems raised by this section have been addressed earlier. This definition may encompass not only "traditional" utilities but also other entities which seek to sell or market power in the state. Such entities may be required, among other things, to obtain Commission approval to provide service under Section 393.170; authority to finance under Section 393.180, 393.200, 393.210 and 303.220; and so forth.

2. Missouri Constitutional Provision.

Article VI, Section 27 of the Missouri Constitution contains language which states

> ...No such joint board, commission, officer or officers established by a joint contract, or any joint venture or cooperative action or undertaking of any kind or character shall purchase, construct, extend or improve any revenue producing water, gas or electric light works, heating or power plant unless and until such joint boards, commissions, officer or officers, or any joint venture or cooperative action and all utility operations conducted by any joint board, commission, officer or officers are fully regulated in all respects as a public utility.

This constitutional provision should not mistakenly be construed to mean that any revenue producing electric business in Missouri must be regulated by the Public Service Commission.

G. Changes in State Law May Be Necessary to Accommodate Anticipated ISO Structure.

The committee has reviewed existing state law in consideration of the most likely structure of an Independent System Operator ("ISO").[1] The result of this view is that there are no general impediments in existing state law to the implementation of such an organization. What is essentially a delegation of operational authority, i.e., control/management, to an ISO by the participant utilities would amount to a transfer such that definitional sections "electric plant" and "electrical corporation" would apply, as would Section 393.190.1 respecting transferring any part of a system necessary or useful in the performance of duties to the public, or by any means, direct or indirect, merge or consolidate such system, or any part thereof, with any other corporation, person or public utility. Should the structure of the ISO be such that the organization might in fact own "electric plant," there could be potential implications under those statutes that would need modification.

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[1] The term has also occasionally been used to denominate an "independent services organization," but that term connotes a different function than that referenced here. Although an ISO could potentially assume several forms, the anticipated structure, marked out by FERC in its relevant orders, suggests that an ISO might own some limited property, but would not own utility plant, even if such plant were constructed at the direction of the ISO governing authority.

H. Other Statutory Issues.

1. Sunshine Laws

The Legal Committee also notes that the so-called "Sunshine Laws" may have some implications for municipal utilities. In very general terms, these statutes require that records relating to the operation of the utility be publicly available. Some municipalities perceive that this places them at a disadvantage in that their participation, purchase prices and planning become public. While not diminishing the importance of this issue to municipals, the committee did not view these statutes as "impediments" to retail competition of the same nature as those statutes noted above.

2. Proposition 1

There is this question of the applicability of Section 393.135 to "stranded investment" resulting from retail competition, i.e., must "stranded investment" be removed from rate base. Section 393.135, often referred to as "Proposition 1" or the "used and useful statute," states as follows:

> Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited.

3. Eminent Domain Laws

Another similar area of possible consideration is the difference in condemnation authority presently held by public utilities. Concerns have been raised by some potential participants in the future marketplace that private utilities have broader rights to acquire private property for public use than do municipals and cooperatives. While municipal and cooperative utilities have similar rights <u>within their service territories</u>, they may not have rights as broad as those of private utilities once those limits are crossed.

A related issue is the question of eminent domain authority for private power suppliers who might seek to locate a generating plant in Missouri but would not be affiliated with an existing public utility, cooperative or municipal entity. While not an existing impediment, facilitation of such installations could benefit competition and contribute lower costs within Missouri, but might not be supported by existing law.[2]

Somewhat on a similar basis to the "Sunshine" laws mentioned above, these differences could raise what some characterize as "level playing field" issues in that unequal rights could result in unequal competitive positions. Approached from this perspective, one solution might be to withdraw eminent domain authority from all market participants. Alternatively, all market participants could be granted equivalent authority. The Market Structure Working Group Report has noted some of these issues.

That Working Group did not see these differentials as "impediments" to competition, but rather as "selective restrictions" the removal of which could lead to enhanced competition or equivalent access from all market participants. Nonetheless, the Legal Committee believes it was appropriate for noting in this report as an area for legislative evaluation.

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[2] In some instances such entities (e.g., Exempt Wholesale Generators, or "EWGs") might obtain authorization at the federal level in which case state eminent domain authority would not be needed.