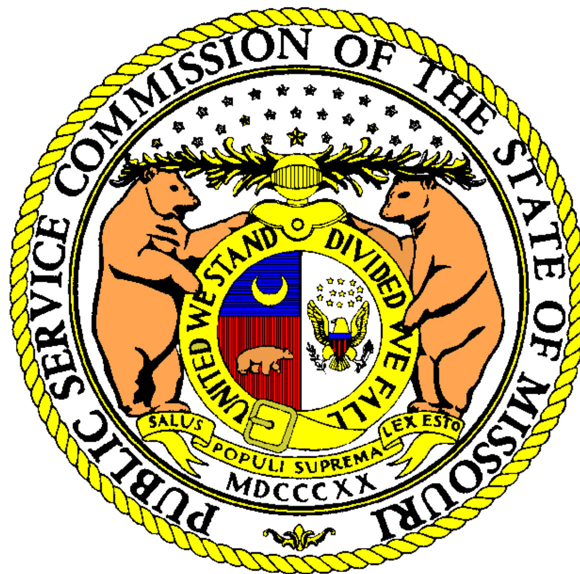
POLICY CONSIDERATIONS

ENERGY SELLERS REPORT



CASE NO. GO-2004-0195

** **Denotes Highly Confidential Information** **

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SUMMARY

Under Sections 393.297-.302 RSMo, which became effective on July 10, 1998, specified sellers of electricity and gas, for use or consumption within Missouri were required to register with the Missouri Public Service Commission (Commission).

During 2003, when Missouri school programs became eligible to acquire their own gas supply and utilize LDC transportation services, the Staff of the Missouri Public Service Commission (Staff) received a number of inquiries from schools, regarding the certification of natural gas marketers. As a result of those inquiries, the Staff had several concerns and requested the Commission open a docket to investigate companies that may be selling electricity or gas without certification from the Commission pursuant to applicable statutes.

Upon completion of its investigation, Staff now concludes that certification of "upstream" transactions is not required and the evidence that downstream passage of title is not occurring makes its previous concerns moot. However, Staff offers three recommendations:

(1) The Commission's website should be updated to include a list of registered Energy Sellers along with clear statements on the scope of the existing Energy Sellers review process.

(2) If the Commission desires to consider a more level tax paying field, amended legislation should be considered to allow the gross receipts based franchise tax to be replaced by a consumption tax on the end-use customer. The Staff is neither advocating nor opposing a new tax but merely suggesting a possible alternative in the event these taxes are restructured. If new legislation is proposed it should also require the LDC to perform the role of tax collector; and

(3) The Commission consider the effect of limited marketer participation in this state.

A related Staff legal memorandum is attached to this report as Appendix A.

BACKGROUND

Background Of This Docket

The statutory requirement of registration is a simple process. The energy seller must be certified as a "seller" by the Commission, and must enter into an agreement with the appropriate political subdivision to pay all applicable business license taxes and must file such agreement with the Commission. The Commission has promulgated a rule to set filing requirements regarding certification of gas sellers, 4 CSR 240-3.285, as required by Section 393.299.4 RSMo.

The Staff's October 2003 *motion to open docket* stated:

> Recently, Staff was contacted by a school official in Salem, Missouri. This inquiry concerned a particular company offering energy services in Missouri. The particular inquiry was about an entity known as Cornerstone Energy (Attached hereto as Exhibit 1). In its written response, Staff stated that it had no information regarding the financial capabilities of Cornerstone Energy or its customer service capabilities (Attached hereto as Exhibit 2). However, had Cornerstone Energy registered with the Commission, certain limited information regarding Cornerstone Energy would have been available.
>
> There are currently three certificated sellers of energy pursuant to this service. They are Enserch Energy Services, Inc.; Woodward Marketing, LLC; and Strategic Energy, LLC. Staff is not sure that all of these entities are still in the business of providing energy services. (Note: ConocoPhillips was added in April 2004)
>
> It appears that energy services are very likely being offered in Missouri by entities not registered with the Commission, in violation of Sections 393.297-.302 RSMo. This statement is based both on information gathered by Staff suggesting that other entities may be offering energy

> services without registering with the Commission and the specific example of Cornerstone Energy.
>
> 10. Staff believes that the "Missouri 'Guaranteed Price' Program" offered by Cornerstone Energy in Missouri is a bundled service, in that, it includes all aspects of the gas purchasing process for customers or consumers (Attached hereto as Exhibit 3). Cornerstone Energy is clearly offering service that uses, leases or controls the distribution system of a distributor, in this case, Aquila. Staff believes it is clear that Cornerstone needs to register as a "seller" under Section 393.297-.302 RSMo and has not done so.
>
> 11. Staff is also concerned that Cornerstone Energy may be violating Section 386.250 RSMo by selling gas and not obtaining a certificate of convenience and necessity from the Commission allowing it to do so. This same concern applies to other entities offering the same or similar services as Cornerstone Energy. Staff believes that some of these third party marketers qualify as "gas corporations" and must obtain a certificate of convenience and necessity from the Commission.

On December 9, 2003 the Commission issued an Order Opening Case, Adding, Parties, Directing, Notice And Setting Prehearing Conference (Order). The Commission stated as follows:

> The Commission has reviewed Staff's motion and finds that Staff's request is reasonable and will grant the motion. The Commission will require that Staff investigate and report on the following items:
>
> a. What sellers are providing "energy services" as defined by Sections 393.297-.302, RSMo 2000?
>
> b. Of these sellers providing "energy services," which ones are operating without the required certification from the Commission?
>
> c. Are any of these sellers affiliated with electric and gas distributors in Missouri?
>
> d. Are these sellers registered with the Missouri Secretary of State to do business in Missouri?
>
> e. Should the Commission's certification process be modified to address the financial, technical, and managerial capabilities of sellers providing service in Missouri?
>
> f. What plan of action do the parties in this case recommend to ensure full compliance with the statutes by all energy sellers?

On February 4, 2004, pursuant to Commission Order a Prehearing Conference was held. As a result of that prehearing, there were discussions regarding the interpretations of the Energy Sellers Statute and a general notice was given that Staff would be conducting discovery in order to provide complete answers to the questions set out at the beginning of the case. Some of the Parties prepared and forwarded to Staff, their legal interpretation of the Energy Sellers statute and Staff responded. The legal interpretation of the statute will be addressed in this case.

Overview of the Natural Gas Industry

It is critical to fully understand the various segments of the natural gas industry when reviewing the interpretation and application of the Energy Sellers statute.

Typically referred to as the "wellhead" segment of the industry, the production area encompasses the exploration and development of natural gas reserves. The natural gas commodity is often gathered from various wells through smaller diameter pipes called "gathering lines." Frequently natural gas may be "processed" in order to remove other valuable liquids for sale or separate out undesirable parts of the gas stream. One of the goals of processing the gas is the effort to meet "pipeline quality standards" before transportation in long-haul interstate pipeline systems. Congress generally price-deregulated the wellhead segment of the industry through a gradual process starting in 1978 and concluding with the Natural Gas Wellhead Decontrol Act of 1989 (remaining price ceilings removed in 1993).

Another major segment of the industry is the interstate pipeline system. Interstate pipelines are regulated by the Federal Regulatory Energy Commission's (FERC). These pipelines are responsible for transporting the natural gas commodity from the production areas (major producing areas in the US include Texas, Oklahoma, Western Kansas, the Rocky Mountain area, and the Gulf Coast) to markets throughout the US. The pipelines are cost-of-

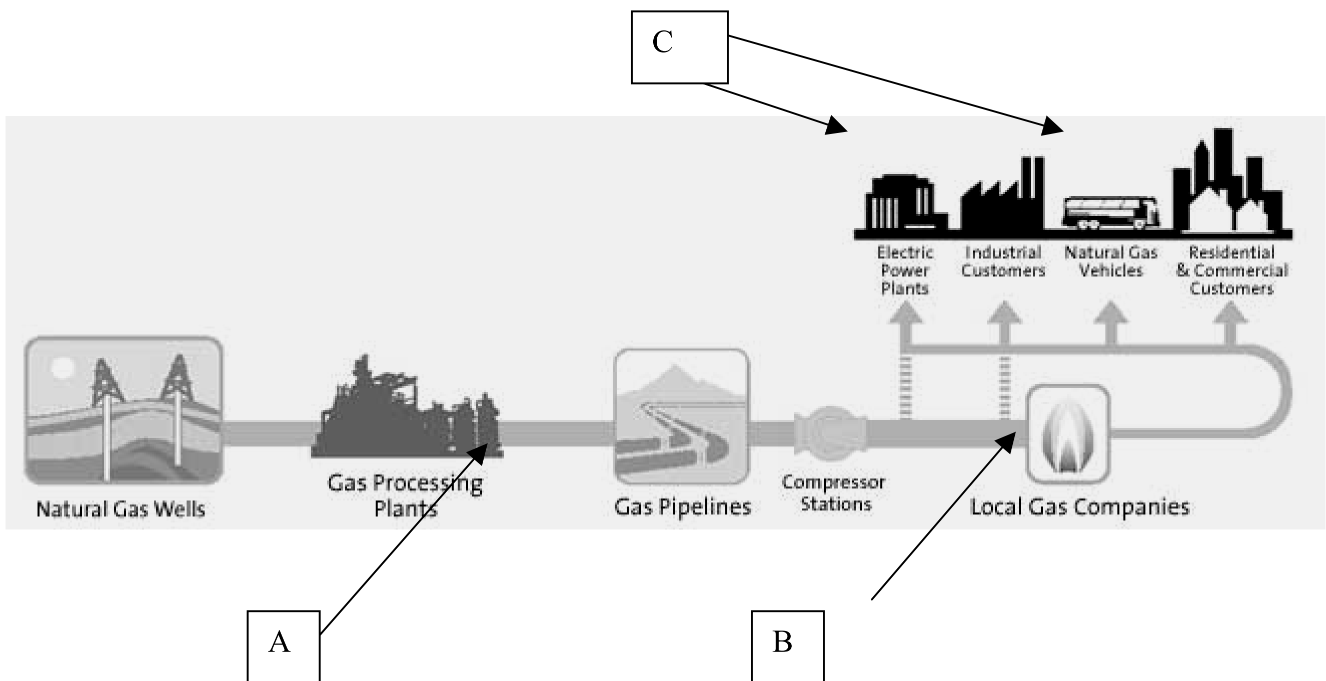
service regulated. A related segment of the pipeline industry includes "*intra*state" pipelines that operate within the borders of a particular state. They share many of the same characteristics of interstate pipelines except a state commission often regulates them rather than the FERC. For the purposes of this report inter and intra state pipelines will be referred to interchangeably although the jurisdictional responsibility varies.

Local Gas Distribution Companies (LDCs) comprise another segment of the natural gas industry. They deliver the gas from the "city-gate" (a point of interconnection between the inter/intra state pipeline and the LDC) to the end-use customer. Unless owned by a municipality or federal agency, LDCs are regulated by state utility commissions. LDC services to the end-use customer can be broken down into two broad categories. If the LDC procures the natural gas commodity and "upstream" (before the city-gate) transportation for the customer, a Purchased Gas Adjustment (PGA) will be applicable. If the end-use customer is eligible for transportation on the LDC's system, doesn't require PGA applicable services, and opts to arrange for its own gas supply and upstream transportation, it is typically considered a "transportation customer". Transportation customers buy natural gas in the open market and generally are not subject to PGA charges with the occasional exception of miscellaneous transition, balancing and/or special back-up service charges.

End-use customers, the final segment in the gas supply chain, are usually subdivided into several categories. The typical situation is where the interstate pipeline interconnects with an LDC at various city-gates. The LDC then delivers the natural gas to end-use customers including residential, commercial, and industrial customers. However, some of the largest natural gas customers might be served directly from an interstate pipeline and could include electric power plants that burn natural gas or large industrial consumers.

Another segment of the natural gas industry includes marketers and brokers. These companies help arrange for natural gas supply, often handling the nomination and coordination of deliveries. Marketers are often distinguished from brokers by the concept of who owns title to the natural gas commodity (and possibly pipeline delivery capacity). Marketers typically hold title to the gas supply, while brokers/agents merely match customers with suppliers.

The following diagram provides a useful illustration of the interaction of the various parts of the industry. The flow diagram is provided courtesy of the Natural Gas Council; the descriptions of common pricing and title transfer points are the Staff's.



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Point A indicates the beginning of the interstate pipeline system. It is often characterized as "pipeline receipt" points and is a common area of title transfer for the gas commodity. It is also a typical pricing point, and is commonly referred to as "into the pipeline" pricing. Many indexes are compiled by natural gas publications and often are referenced to major receipt points

or hubs at the beginning of the pipeline systems. Index pricing refers to the practice of relying on published samples of natural gas trades to set a price in a natural gas commodity contract.

Point B, another common point of title transfer, is the interconnection between an inter (or intra) state pipelines facility and an LDC's distribution system. If a marketing company sells gas at the city-gate to an end-user transportation customer then title would have passed from the marketer to the end-user at that point. The transaction would be at retail because the gas is for the customer's end use and is not being resold.

Point C represents the "burner-tip", i.e. where the gas is burned and/or delivered to the ultimate consumer. Often the phrase "from well-head to burner tip" is used to describe a transaction that might include all the charges and services necessary to procure and deliver gas from the production areas to the premises of the local consumer.

Other common concepts used to describe the flow of gas include the term "upstream" which usually indicates activity closer to the production or wellhead area. For example if a transaction occurs "upstream" of the city-gate, the transaction would reference an event that happened before the gas was delivered to the LDC's distribution system. The term "downstream" means an event closer to the ultimate consuming market. Downstream of the interstate pipeline system would include the LDC distribution system and customer facilities.

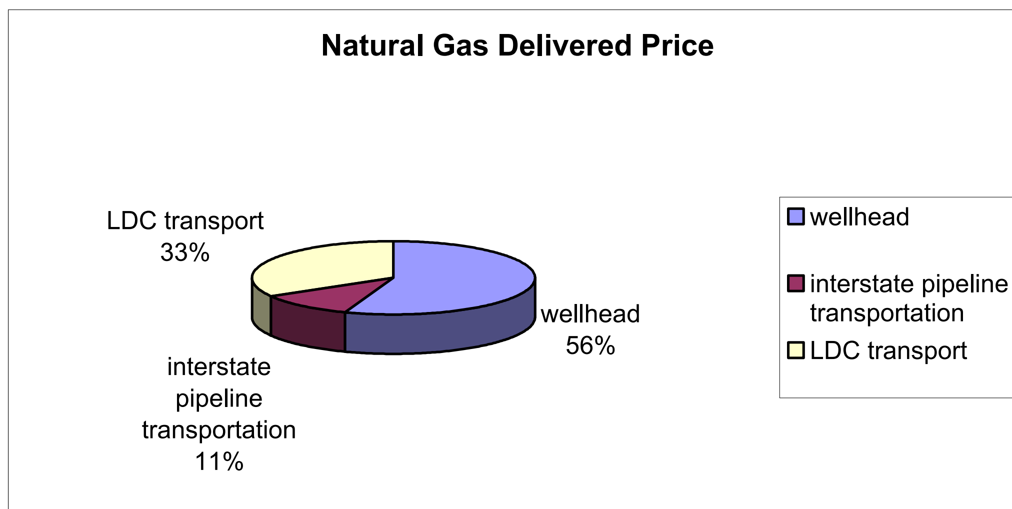
The term, "bundled sale", describes a situation where one or more components of the natural gas transaction are combined. An example of a bundled sale would be a situation where the gas supply, interstate pipeline transportation, and LDC transportation was wrapped or bundled into one overall package at one delivered price. Bundled transactions are more common in jurisdictions that have authorized unbundling of various services that are "repackaged" into one bill.

Billed Revenues

It is also critical to understand the typical components of a natural gas bill. There are many ways to categorize the charges on gas bills, but for purposes of this discussion it is useful to breakup a typical bill in terms of the natural gas commodity, natural gas inter/intra state transportation, and LDC charges.

The following data table and related chart show the breakdown using illustrative prices.

$/Mcf	% Of total	Description
$5.00	55.56%	Wellhead
$1.00	11.11%	Pipeline transportation
$3.00	33.33%	LDC distribution
$9.00	100.00%	Total delivered price (excluding gross receipts taxes)



The chart assumes a wellhead price of $5.00/Mcf. This price is essentially deregulated in terms of the competitive market for natural gas supply. It might be an indexed price or a fixed price in terms of the underlying natural gas commodity contract. Natural gas commodity prices have exhibited extreme volatility and have traditionally comprised the largest percentage of the typical gas bill. Pipeline transportation charges are presumed to be $1.00/Mcf although this cost varies because of differing system rates and the number of systems used to bring the gas to the city

gate. It is important to note that the PGA element of the bill is comprised of the wellhead or gas supply costs plus the pipeline costs. In this example, the PGA rate would be $6.00/Mcf. **The PGA rate consists of $5.00 for the gas and $1.00 to transport the gas to the LDCs city gate.**

The illustrative LDC charge is $3.00/Mcf, and would include fixed customer charges and non PGA related charges. This charge is often referred to as the non-gas cost portion of the bill or the LDC margin cost, since it is made up of all charges that are not PGA related. The city-gate is usually considered a point of demarcation for PGA charges that are recovered pursuant to the PGA clause versus LDC margin charges that are reviewed in the context of a general rate case.

Franchise taxes (Utility taxes)

In recent years the City of St. Louis' franchise tax rate for companies supplying natural gas has been 10% of the gross receipts from their commercial customers and 4% of the gross receipts from residential customers. Kansas City's tax rate has been 10% for commercial and industrial customers and 6% for residential natural gas customers. When a customer switches from PGA sales service to transportation-only service, a city charging a franchise tax based upon gross receipts potentially loses a taxable revenue base of $6.00/Mcf multiplied by the customer's consumption. However, other variables, such as weather, general rate cases, and PGA rate changes can also significantly impact franchise tax collections. For example, according to a Kansas City, Missouri budget report, a 7% to 8% decline in the PGA rate reduced natural gas tax revenue by $1.0 million.

It is also noteworthy that franchise taxes related to commercial and industrial natural gas is only a part of total natural gas franchise tax collections, since franchise taxes apply to residential (PGA applicable) revenues as well. Also, franchise tax is collected on electric and

telephone service, making the commercial and industrial natural gas related percentage even less from that perspective. Finally, the St. Louis and Kansas City total revenue budgets are comprised of additional revenue sources meaning that *total* franchise taxes represent a subset of the total resources. From an industrial customer's viewpoint, the tax avoidance of switching from sales service to transportation service yields an automatic savings (10% multiplied by the gas supply and transportation services purchased upstream of the city gate).

The migration of industrial and larger commercial customers from PGA sales service to transportation service occurred long before the effective date of the Energy Sellers Statute. In Case No. GO-85-264, *Investigation of Developments in Natural Gas Transportation Industry and Relevance to Regulation*, the Commission established guidelines for the implementation of transportation tariffs for larger LDC customers. While that Order had an effective date of September 18, 1986, most of the transition to transportation took place in the late 1980s and early 1990s. Therefore, the negative revenue impact to municipalities was spread out over time, and possibly masked by other changing variables such as departures from normal weather or changes in the overall level of PGA costs.

The stated legislative intent of the 1998 Energy Sellers Statue was to put traditional gas sales service and transportation service on a "level franchise tax-paying field". Presumably, municipalities and political subdivisions would not suffer revenue shortfalls as a result of LDC customers switching from sales service to transportation service, if natural gas marketing companies were to pay franchise tax on the gas supply and interstate pipeline transportation charges collected from transportation customers.

The Staff Investigation

During the course of its investigation, the Staff issued data requests, evaluated responses, and issued follow-up data requests. Unfortunately, this case was delayed because of several cases that were filed, usually with requests for expedited treatment, during the summer and late fall of 2004.

As the Staff indicated in its October 24, 2003 Motion to Open Docket:

> Sections 393.297-.302 RSMo became effective on July 10, 1998. These statutes enact a statutory system requiring registration of certain sellers of electricity and gas for use or consumption within Missouri. Under these statutes, specified sellers of electricity and gas, for use or consumption, within Missouri must register with the Missouri Public Service Commission.

The Staff further explained in the October 24, 2003 Motion:

> In Section 393.297.1 RSMo 2000[1], the General Assembly clearly set out its intent in the passage of this act. The General Assembly stated its intent as follows:
>
> (1) To maintain a fair and equitable tax structure and to preserve the local tax base by requiring all persons who provide electricity or gas service to pay an equitable share; and
>
> (2) To equalize the amount of business taxes, franchise fees and payments in lieu of taxes on competing suppliers of electricity and gas service.
>
> (3) To restore to political subdivisions revenue sources that existed prior to any previously implemented gas industry restructuring.
>
> (4) To remove disparities in the liability of natural gas suppliers for business taxes, franchise fees, and payments in lieu of taxes, which disparities have arisen as a result of any previously implemented gas industry restructuring.

Although these goals are clearly explained, statutory language that followed these introductory "statements of intent" appears to have allowed some transactions the capability of avoiding franchise tax assessment. The statute provided definitions, which were somewhat unclear when applied to the actual circumstances that existed in the natural gas industry.

[1] All references to the Revised Statutes of Missouri shall be RSMo 2000 unless otherwise specified.

Ultimately this resulted in only three companies that voluntarily filed in the first 2 years following the statutes' effective date as energy sellers under the related rule (4 CSR 240-3.285). As can be seen in the following table, three companies filed within the first two years of the statutory effective date. In total, to date, only four companies have filed for certification.

Certificated Seller of Energy		Case No.	Effective date of Order
Enserch Energy Services, Inc.		GO-99-124	11/3/1998
Woodward Marketing, L.L.C.		GO-99-163	11/27/1998
Strategic Energy, L.L.C.		GO-2000-635	5/12/2000
ConocoPhillips Company		GA-2004-0343	4/9/2004

The Staff investigation included a detailed legal analysis of the statutes including an evaluation of the legal opinion of most of the other parties to this case. It also included the issuance of numerous data requests, most of which were directed at understanding the nature of marketing services rendered to end-user transportation customers.

As a result of the Staff's investigation, it was found that most, if not all transactions related to the sale of gas supply and/or interstate pipeline transportation occur upstream of the city-gate. This conclusion was based upon a review of a sample of contracts between marketers and end-user customers. LDC tariffs typically define a customer as the end-user of gas, or the party ultimately responsible for paying for the gas consumed and they generally preclude the subleasing or use of LDC capacity by a marketing company.

Given existing rules and regulations now in effect, Staff does not believe that title for natural gas supply can pass at the burner-tip (or customer's meter) between a marketing company and the end-user transportation customer. If a marketing company contracts for transportation services on the LDC's distribution system and resells the LDC distribution services to customers downstream of the city-gate, arguably the marketing company is subject to full regulation as a

gas corporation or possibly requires Commission certification and. approval prior to the sale, transfer, or leasing of assets.

Unfortunately, a finding that the Energy Sellers Statute is basically applicable to sales made *downstream* of the city-gate renders it ineffectual in terms of capturing lost PGA revenues from commercial and industrial transportation customers. The logical progression of argument is as follows:

A. Only marketers that make the sale *downstream* of the city gate must be certified.

B No marketers are authorized to make sales *downstream* of the city gate.

C. Therefore, no marketers are required to be certified.

This conclusion is further supported by the fact that another part of the Energy Sellers Statute appears to give political subdivisions, with voter approval, the ability to impose a tax on marketers' transactions downstream of the city gate.

This part of the statute reads as follows:

> 393.302. Notwithstanding the provisions of section 393.299, a political subdivision may by ordinance impose a tax upon persons who use or consume gas, electricity or energy services within such political subdivision but who take title to such gas, electricity or energy services outside of that political subdivision. Any person liable for the tax under this section, upon proof that such person has paid a tax in another state or political subdivision with respect to a charge for the sale or transfer of such gas, electricity or energy services, shall be allowed a credit against the tax authorized by this section, to the extent of the amount of the tax legally due and paid in the other state or political subdivision with respect to such charge. The tax shall be measured by all charges for gas, electricity or energy services by the person using or consuming the gas, electricity or energy services at a rate equal to the rate of the applicable business license tax, as authorized in section 66.300, RSMo, section 71.610, RSMo, section 92.045, RSMo, section 94.110 or 94.360, RSMo, or the applicable franchise fee. Such tax shall not become effective unless the governing body of the political subdivision submits to the voters of that political subdivision at any public election allowed pursuant to subsection 1 of section 115.123, RSMo, a proposal to impose a tax

> under the provisions of this section. The question shall be submitted to the voters in substantially the following form:
>
> Shall the . . . (political subdivision) levy a tax for the purpose of equalizing the obligations of all users of gas, electricity or energy services of a percent which is equal to the obligations of current taxpayers on the purchase price of gas, electricity or energy services sold by any person, corporation or other business entity for ultimate use in the political subdivision but not subject to the current tax?…

Significant goals of the legislation are not being accomplished

It is noteworthy to view the statutory intent in light of the circumstances that occurred subsequent to the statutes' enactment. The following discussion contrasts the legislative intent versus the ultimate effect of the statutory provisions.

393.297. 1. It is the intent of the general assembly through the passage of this act:

> (1) To maintain a fair and equitable tax structure and to preserve the local tax base by requiring all persons who provide electricity or gas service to pay an equitable share;

The tax structure generally favors transportation service over sales service. If a transportation customer avoids the PGA, which is generally only applicable to sales service, it avoids the taxes that would have been levied on PGA revenues. All persons who provide gas service are not paying an equitable share since an LDC providing sales service must charge end-user customers applicable franchise taxes while marketers who provide similar services do not charge end-use customers for these taxes. It is more accurate, however, to characterize LDCs as "collectors" of franchise taxes rather than "payers" since the tax is ultimately the liability of the end-user. Since the implementation of LDC transportation services, a fundamental concept of rate design has been to make the LDC indifferent about the end-user customers' choice between transportation and sales service by making the impact of those customer decisions revenue neutral for the LDC.

> (2) To equalize the amount of business taxes, franchise fees and payments in lieu of taxes on competing suppliers of electricity and gas service.

This provision implies a "level playing field" for competing suppliers. As previously discussed, there is a bias in how tax is applied and collected that favors transportation service. Unless political subdivisions adjust tax rates, or tax bases, a loss of franchise tax revenues would result from the migration of industrial and commercial customers away from PGA sales service to transportation service, all other things being equal.

> (3) To restore to political subdivisions revenue sources that existed prior to any previously implemented gas industry restructuring.

Many industrial and commercial customers converted to LDC transportation service during the late 1980s, reducing the total revenues of LDCs and thereby reducing the franchise tax base for Missouri's political subdivisions. By the time the Energy Sellers Statute was enacted in the late 1990s political subdivisions had likely adjusted their budgets for nearly a decade to reflect the franchise tax reductions caused by the restructuring of LDC services.

> (4) To remove disparities in the liability of natural gas suppliers for business taxes, franchise fees, and payments in lieu of taxes, which disparities have arisen as a result of any previously implemented gas industry restructuring.

To the extent that the general provisions of the Statute could not address these disparities the Statute provided for a "consumption tax". However to Staff's knowledge, these consumption type taxes have not been implemented.

> 2. Political subdivisions provide police, fire and public health services, including the inspection of gas and electric equipment and other facilities used in the consumption of gas and electricity. Political subdivisions impose license taxes, franchise fees and sales taxes on providers of electricity and gas services, and require payments in lieu of taxes from publicly owned utilities in order to pay for these and other services related

> to the transportation, use and consumption of electricity and gas services and for the general operation of government.

This provision simply emphasizes the relationship between the services that political subdivisions provide and the reason for taxing providers of electricity and gas services.

> 3. Missouri has historically restricted competition with respect to electricity and gas services by authorizing the Missouri public service commission to limit the number of providers and has allowed political subdivisions to require franchises for these services. Persons entering the gas and electric markets within Missouri receive substantial revenues from consumers in Missouri, thereby creating a purposeful economic presence in this state. In addition, these persons may also cause electricity and gas to be transported over rights-of-way and utility easements and may use electric lines or gas lines which are owned, controlled and maintained by other public and private entities in this state. Unless all participants in the electricity and gas markets pay comparable taxes and fees, there will be significant tax and franchise fee revenue losses by political subdivisions and unfair competitive disparities among such participants.

All participants were not paying comparable taxes and fees because of the disparity between the taxation of PGA sales versus the taxation of "transportation only" service. There was a potential loss of tax and franchise fees by political subdivisions that may or may not have been recouped by those same political subdivisions. There were many variables that ultimately affected a particular political subdivision's tax revenue, including the effect of weather and the price of the gas commodity on PGA revenues, as well as adjustments to the tax rate itself. All other things being equal, a switch from PGA sales service to transportation only service resulted in a tax savings for the end-use transportation customer equal to the tax rate multiplied by the taxable PGA revenues and a corresponding reduction to a political subdivision's franchise taxes.

> 4. The legislature finds that electricity and gas are essential, but potentially dangerous, commodities in modern society. The electricity transmission and distribution system is an interconnected and interdependent grid. Therefore, the legislature finds that it is in the interest of public health and safety to require registration of all sellers of electricity and gas for use or consumption within Missouri.

This provision of the statute appears to go beyond previous discussions of legislative intent to equalize competitive disparities due to tax effects on political subdivisions. It appears to envision a time where sellers of electricity and gas have greater access to customers; thus inferring that evaluating an energy supplier's customer service, financial standing and, creditworthiness, safety standards, and other customer protections might be part of the registration process.

In other states, these additional requirements appear to be in place as the result of a more extensive restructuring process that has often included the residential customer. In Missouri, the review and certification process and been directed at ensuring that there is an agreement from the marketer to collect any taxes that are due and has nothing to do with the reliability or creditworthiness of the marketing company. It is unfortunate that the mere reference to "certification" or "registration" may imply a seal of approval of the marketing company.

In the rare times that a marketing company has registered, the applicant merely agrees to the following statutory conditions:

(1) Applicant agrees to pay business licenses taxes, franchise fees or PILOTS as required pursuant to section 393.299 RSMo.

(2) Applicant waives its right to challenge the validity of the agreement.

(3) Applicant waives its right to the refund of amounts paid pursuant to the agreement.

(4) Applicant will make its books and records available to the Commission and political subdivision for review.

The review and approval process has not been any more extensive than ensuring that these assertions are documented.

Number of natural gas marketers and marketer concentration

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Staff's response to the six questions put forth in this docket

The Staff's original motion and the Commission's authorizing Order posed six questions. The Staff answers them as follows.

What sellers are providing "energy services" as defined by Sections 393.297-.302, RSMo 2000?

Although there are about ** __ ** natural gas marketers offering retail services to commercial and industrial natural gas customers in the state, none are providing "energy services" as that term is used in the rule. The Staff's interpretation of this rule is that energy services are related to a specific service that is delivered to the end-user's premises. The rule implies a control or direct use of the LDC's distribution system by a "seller." While this investigation related to natural gas marketers, it should also be noted that the statute and the issue

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of where title passes may have some applicability should further restructuring occur in the electric industry.

Of these sellers providing "energy services," which ones are operating without the required certification from the Commission?

None, since no natural gas marketing companies appear to be offering sales at the burner-tip.

Are any of these sellers affiliated with electric and gas distributors in Missouri?

Although there are natural gas marketing companies affiliated with gas distributors in Missouri, since there are no "sellers", there are no "affiliated sellers".

Are these sellers registered with the Missouri Secretary of State to do business in Missouri?

Again, the Staff's interpretation is that there are no "sellers" as defined by the statute. Therefore, since there are no sellers, the question can be answered as not applicable.

Should the Commission's certification process be modified to address the financial, technical, and managerial capabilities of sellers providing service in Missouri?

While some states perform more extensive certification reviews, the Staff does not believe Missouri's certification process should be modified at this time. The present practice of limiting the review to an assessment of whether the applicant will collect any taxes that might be due is consistent with the limited requirements of the statute and Commission rule. A more detailed review of marketers' creditworthiness and supply capabilities would be suggested if access to transportation were to be expanded to small commercial customers and/or residential

customers, as those customers often do not have the experience or expertise to negotiate and contract for natural gas supply and transportation services.

What plan of action do the parties in this case recommend to ensure full compliance with the statutes by all energy sellers?

To permit quick access for the public as to which companies are certified, the Staff suggests that a list of certified marketing companies be made available on the Commission's website. In addition, so that it is clear what certification means in Missouri, the website should in state that certification means no more and no less than the:

> 1) Applicant agrees to pay business licenses taxes, franchise fees or PILOTS as required pursuant to section 393.299 RSMo.
>
> (2) Applicant waives its right to challenge the validity of the agreement.
>
> (3) Applicant waives its right to the refund of amounts paid pursuant to the agreement.
>
> (4) Applicant will make its books and records available to the Commission and political subdivision for review

These recommendations would offer quick access for the public as to which companies are certified. Staff believes that it would also clarify that certification is not meant to be a "seal of approval" and should not be used as a substitute for the customer's own due diligence in researching the marketer's ability to perform and carryout a specific contract. Staff further recommends that it be clearly stated that the Commission's role in the certification of Energy Sellers is largely a ministerial role and that the Commission does not conduct any real investigation into the Energy Seller's financial or other ability to deliver the services being offered nor does the Commission have any authority to regulate the Energy Seller once it is certified.

In addition, as a practical matter, since the end-use customer will ultimately have to pay for any tax levied against an upstream service provider, it would be more logical to directly tax the end-use customer and require the LDC to perform the role of tax collector. The Staff would also suggest that any future attempts to expand the statutes application should be accompanied by a "gate-keeping" function for the LDCs since these companies generally can limit access to transportation service through their tariffs. In other words, a more practical means of assessing these taxes would require the LDC to collect the tax directly from the end-use customer.

Lastly, further reflection/consideration should be given to evaluating the effect of limited marketer participation in this state.

STAFF'S LEGAL MEMORANDUM ON ENERGY SELLERS

PROCEDURAL HISTORY

On October 24, 2003, Staff filed a Motion to open a case with the Missouri Public Service Commission (Commission). As part of this Motion, Staff set out six questions to be answered by this investigation. On December 9, 2003, the Commission issued its Order Opening Case, Adding Parties, Directing Notice and Setting Prehearing Conference (Order). The Commission set a prehearing conference for February 4, 2004.

The Prehearing Conference was held on February 4, 2004. Some Parties asserted that the statute only applies to an energy seller holding title from wellhead to burner tip, a fully bundled service. These Parties also stated that there are very few such players; though a fully bundled service may actually qualify. The Parties prepared a legal memorandum and Staff responded. This Memorandum is an adaptation of Staff's Memorandum to the Parties.

STATUTES

In order to interpret the statute, it is necessary to set out specific parts of the statute. The General Assembly stated as follows regarding its intent:

It is the intent of the general assembly through the passage of this act:

> (1) To maintain a fair and equitable tax structure and to preserve the local tax base by requiring all persons who provide electricity or gas service to pay an equitable share; and

(2) To equalize the amount of business taxes, franchise fees and payments in lieu of taxes on competing suppliers of electricity and gas service.

(3) To restore to political subdivisions revenue sources that existed prior to any previously implemented gas industry restructuring.

(4) To remove disparities in the liability of natural gas suppliers for business taxes, franchise fees, and payments in lieu of taxes, which disparities have arisen as a result of any previously implemented gas industry restructuring.

Section 393.299.1 RSMo 2000 provides that:

> 1. No person, other than a distributor or a political subdivision operating within its territorial limits, shall provide energy services in a political subdivision which has business license taxes in effect . . . on persons who sell energy services unless the person is certified by the commission as a seller and files its agreement with the commission to pay to the political subdivision all applicable business license taxes.

"Energy Services" is defined in Section 393.298(4) as:

> the retail sale of electricity or nature gas, propane or methane to customers or consumers and all associated services that are necessary for their delivery through a distribution system including but not limited to the generation, production, transmission, distribution, billing and metering of such services.

"Distribution System" is defined in Section 393.298(2) as:

> the physical plant used to provide energy services including facilities, structures, wires and appurtenances thereto.

"Seller" is defined in Section 393.298(10) as:

> any person, who uses, leases or controls the distribution system of a distributor or a political subdivision or any part thereof to sell energy services at retail within the political subdivision other than a distributor or a political subdivision that uses its own distribution system.

"Person" is defined in Section 393.298(6) as:

> includes any individual, firm, cooperative, copartnership, joint venture, association, corporation, municipal or private, and

whether organized for profit or not, state, county, political subdivision, state department, commission, board, bureau or agency or any other group or combination acting as a unit, and the plural as well as the singular number.

"Distributor" is defined in Section 393.298(3) as:

an electrical or gas corporation as defined by Section 386.020, RSMo, which is authorized by the commission under this chapter, to provide or distribute energy services.

The primary question is: "What sellers of energy services are covered by the statute?" Two interpretations are possible. One is the interpretation offered some Parties to this case as set out in the letter by Mike Pendergast. The other interpretation would be to give very broad meanings to certain terms to actually give meaning to the stated intent of the legislature. However, as will be seen, there are other factors that must be considered. These other factors lead to a resolution of this matter.

PENDERGAST LETTER

Mike Pendergast's letter interprets the statute as follows:

Specifically, we will address whether the various provisions of this Statute, including the requirements relating to the certification and taxation of energy sellers, apply to marketers who sell gas to Missouri end – users upstream of the city gates of a local gas distribution utility ("LDC"). To the extent such marketers do not "use, lease or control" the LDC's distribution system in making such sales—and to our knowledge they do not—it is our view that the Statute does not apply to such transactions.

As discussed below, we believe that such a conclusion is consistent with the clear and unambiguous language of the Statute itself…

I. When accorded its plain and ordinary meaning, the language of the Statute clearly and unambiguously indicates that its provisions are inapplicable to sales made by marketers who do not use the LDC's distribution system to transport and deliver the gas to the end-user…

A straightforward application of these principles to the relevant provisions of the Statute shows that it does not apply to marketers who sell gas upstream of the LDC's facilities and who therefore do not use the LDC's facilities to transport and deliver the gas to the end-user. By its very terms, the Statute defines the kind of "seller" of energy services that would be subject to its provisions as:

any person, who uses, leases or controls the distribution system of a distributor or a political subdivision or any part thereof to sell energy services at retail within the political subdivision other than a distributor or a political subdivision that uses its own distribution system.

(Section 393.298 (10); emphasis supplied)…

As the above language makes clear, to qualify as an energy seller subject to the Statute's various requirements, the person involved in the transaction must do three things. First, it must use, lease or control the system of the LDC to make the sale. Second, it must be engaged in selling "energy services." And, third, it must be selling such energy services at retail within the applicable political subdivision.

A marketer selling gas upstream of the LDC's facilities, however, does none of these things. Since the marketer is selling the gas to the end-user at a point upstream of the LDC's distribution system, the marketer is clearly not using, leasing or controlling the LDC's system to make the sale. Instead, the end-use transportation customer is the entity using the LDC's distribution system to transport the gas to that customer's location. It is also that customer, and not the marketer, who contracts for the transportation service with the LDC and who is ultimately responsible for paying the LDC for transporting the gas through the distribution system.

Nor is the marketer under these circumstances engaged in selling "energy services" since energy services are explicitly defined under the Statute as "the retail sale of electricity or natural gas, propane or methane to customers or consumers and all associated services that are necessary for their delivery through a distribution system …" Section 393.298(4) (emphasis supplied). This language can only mean that in order for a person to provide energy services within the meaning of the Statute, that person must also be providing the transportation services necessary to effectuate delivery of the energy to the end-use customer. Where the marketer sells the gas upstream of the LDC's distribution system, however, it is the LDC, rather than the marketer, who is providing the transportation services necessary to deliver the gas to the end-user.

Finally, sales of gas by a marketer (who does not use the facilities of the LDC) will in most instances take place outside the political subdivision in which the gas is actually consumed by the end-user. This is due to the fact that the location at which the sale is made to the end-user (i.e. where title passes) will either be in another state (usually at a receipt point on an interstate pipeline) or in another political subdivision (at the city gate of the LDC) than the one in which the end-user is located. Accordingly, in many, if not most, instances no sale at all will take place in the political subdivision where the end-user is located, let alone the kind of sale that is necessary to trigger the Statute's applicability.

> In short, when accorded its plain and ordinary meaning, the language of the Statute clearly and unambiguously indicates that its provisions do not apply to sales made by marketers who do not also transport and deliver the gas through the LDC's distribution system as part of the sale. Under such circumstances, there is simply no "seller" within the meaning of the Statute; no sale of "energy services" as that term is defined by the Statute; and certainly no retail sale of energy services "within the political subdivision" as contemplated by the clear wording of the Statute…

ANOTHER INTERPRETATION OF THE STATUTE

A broader reading, combined with the stated legislative intent in Section 393.297 RSMo 2002, could yield a different result. Statutes that are remedial in nature are to be liberally construed so as to affect their beneficial purpose. *Cidlick v. Subsurface Contractors,* No. ED81858, WL 21692672, Slip. Op. at 2. "The primary role of courts in construing statutes is to ascertain the intent of the legislature…and, if possible to give effect to that intent…avoiding unjust or unreasonable results." Id. at 2.

In order to interpret the definition of "seller" to give effect to the stated legislative intent found in Section 393.297 RSMo 2000, it is necessary to use a very broad definition of the terms "uses," "leases," or "controls." Section 386.610 RSMo 2000 specifically provides that the Public Service Commission Law is to be liberally construed with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities.

A look at some of the basic statutory interpretation rules may help. Statutory interpretation is a question of law. *Anderson v. Village of Jacksonville,* 103 S.W.3d 190, 195 (Mo. App. W.D. 2003). When interpreting a statute, the plain and ordinary meaning of the words is considered. Id. at 195. The primary rule of statutory construction is to ascertain the intent of the legislature from the language used, to give effect to that intent if possible, and to consider the words used in their plain and ordinary meaning. Id. at 195. The entire statute should be harmonized, if reasonably possible. Id. at 195.

There really is no dispute about the distribution system of an LDC. This is the distribution system behind the city gate of the LDC. While the term "city gate" is perhaps a term of art, it is the transfer point from the interstate pipeline to the distribution system of the LDC. This is also known as the LDC interconnect to the interstate pipeline. The issue is whether a marketer acquiring title to gas upstream of the LDC's city gate and passing title at, or before, the city gate "uses, leases, or controls" the distribution system or any part thereof, of a distributor or political subdivision.

The clearest situation would be that a "seller" offers the service of purchasing natural gas for a customer. This seller goes out into the market, purchases gas for its customer, takes title to the gas and delivers it to the burner tip of the customer. This would be a fully bundled service and would be covered by the statute. Mr. Pendergast's letter would support this. However, since under current tariffs and law it is not possible to have title pass beyond the city gate, then no such fully bundled service exists including the service offered by Cornerstone Energy.

Another situation would be wherein the seller goes out into the market, does all necessary tasks to purchase gas for its customer, but acts as an authorized agent and does not take title for the gas. Title to the gas is always in the name of the end-user customer that transports it as a transportation customer of the LDC. The argument is that this is not covered under the statute. The "seller" merely acted as an authorized agent and signed all contracts for the end-user customer. In this situation, the actual seller is the large gas producers; however, the sale most likely took place way upstream of the LDC's distribution system.

Staff received several calls from energy sellers that utilize this type of service. These callers were convinced that the statute does not apply to them because they never take title

to the gas and only act as an agent or advisor providing specific services. They might sign on behalf of the principal or they might ship everything to the principal to sign, but they do not sign in their own capacity or take title to the gas. Such marketers might even arrange for transportation on the LDC's distribution system by acting as an agent for the end-user. While agency law might allow for such an arrangement, it is still necessary to further understand how this arrangement works and verify that such transactions actually occur in this way and do not constitute a sham arrangement to avoid the statute. The Staff however found no instances of an agent that transferred title downstream of the city-gate.

However, there has been discussion about a marketer delivering gas to an LDC city gate and transferring title to the end-user at that stage. While the marketer might have obtained title upstream of the LDC's city gate, if title passes from the marketer that obtained title upstream and transported on the interstate pipeline to the LDC's city gate and there transferred title to the end-user, then it is not covered by the statute because the marketer cannot, under existing tariffs, transport on an LDC's distribution system. That function can only be done by the end use customer.

It is not easy to reconcile the stated legislative intent with the actual words of the statute. However, after further discussions it became clear that the statute does make sense when read with the appropriate legislative history in mind.

LEGISLATIVE HISTORY

One of the primary components of interpreting this statute is to consider the context and the specific knowledge of various individuals surrounding the passage of this statute. As the General Counsel explained, the primary purpose of this statute was to deal with the possible

deregulation of the electric industry in Missouri, as was actively being contemplated in 1998 and the possible loss of gross receipts tax revenue with such deregulation of the electric industry. Such deregulation was the subject of a Commission Task Force and would most likely have involved the divestiture of generating assets.

The specific findings of the legislature regarding this statute support the idea that the primary purpose of this legislation was to focus on electricity. The legislature specifically found that:

> …electricity and gas are essentially, but potentially dangerous commodities in modern society. The electricity transmission and distribution system is an interconnected and interdependent grid. Therefore, the legislature finds that it is in the interest of public health and safety to require registration of all sellers of electricity and gas for use or consumption within Missouri.

The statute, while applicable to electricity and natural gas, when applied to electricity with its interconnected and interdependent grid fits very differently then when the statute is read strictly for applicability to natural gas. Electricity, as the legislature correctly pointed out, is interconnected and has an interdependent grid. In a situation therein, the definition of "seller" fits quite well. Furthermore, as Staff's Report points out, much of the gross receipts tax had already been lost by customers converting to transportation customer status.

A SUBSEQUENTLY PROPOSED AMENDMENT SUPPORTS THIS CONCLUSION

On December 8, 1999, SB 612 was introduced. This bill clearly contemplated the actual collection of taxes including the situation wherein sales take place upstream of the LDC's distribution system. It proposed to amend Chapter 144 and Chapter 393. Pursuant to proposed Section 144.856.5, political subdivisions would have been required to notify the Commission of

any failure to pay any amount required by Section 144.856.1. This proposed section required the energy seller to collect and remit all state and local sales and use taxes for all energy services not excluded by the Department of Revenue. Proposed Section 144.856.3 required the Commission to establish procedures for certification and enforcement pursuant to Chapter 536.

Proposed Section 393.298 contained significant amendments. It added rural electric cooperatives to the definition of "distributor." Proposed Section 393.299.1 appeared to require tariffs be filed by electric and gas corporations to require retail customers to prove that the retail customers are purchasing only from certified energy sellers. There was also a ballot requirement for the new tax in proposed Section 393.302.3 to be submitted to the voters of the political subdivision.

The most notable proposed amendment was to the definition of the term "seller." "Seller" was defined as:

> …any person who directly or indirectly uses, leases or controls the distribution system of a distributor or a political subdivision or any part thereof to sell energy services at retail which are consumed within the political subdivision other than a distributor or a political subdivision which uses it own distribution system, even if title to the energy services passes from such person to the retail customer or a third party outside of a political subdivision or before such energy services enter the distribution system. A retail user of energy services is deemed not to be a seller within the meaning of this section with respect to the energy services it consumes.

While there are some cases regarding interpretation of statutes' legislative intent based on subsequent amendments, nothing was found directly addressing the subject of what effect, if any, a proposed amendment has on determining legislative intent of an existing statute. If nothing else it can be instructive. This amendment shows that the Legislature noted a problem with the limited applicability of existing Sections 393.297-302. This would suggest that the Legislature

realized the problem with a statute drafted for electric deregulation not exactly fitting the natural gas industry.

ANOTHER PROBLEM

Sections 393.297-.302 RSMo 2000 apply to sellers providing energy services. These statutes do not put any requirements on recipients or purchasers of energy services. Furthermore, the statute only applies to sellers of energy services that actually occur within the political subdivision. As Mike Pendergast's letter correctly points out, many of these sales of natural gas do not take place within the political subdivision. For this reason also, the statute has very limited applicability to many natural gas sales wherein the sale, passing of title, occurs outside the political subdivision.

CONCLUSION

For the reasons stated herein, Staff believes that this statute was passed to address loss of local tax revenue in the contemplation of expected electric deregulation. This has not occurred and the statute is still on the books.

Furthermore, the matter that brought this entire case to Staff's attention still needs to be addressed. The fact is that it is not currently possible for energy sellers to offer and provide a fully bundled service. While it is possible to offer something akin to it as was done by Cornerstone Energy, the issue is how the Commission informs the public about its duties regarding Energy Sellers.