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ATTACKS ON EXECUTIVES: REVIVAL OF THE INVASION OF MANAGEMENT DEFENSE AND PUBLIC UTILITY AUTONOMY

As the Chief Executive Officer of Westar Energy, Inc., James Haines Jr. oversees the largest power company in Kansas, a company that provides power to a good portion of Kansas and parts of several other states. Through years of education and experience working in this field and with this company, Mr. Haines has gained a deeper understanding of the business needs that present themselves on a day-to-day basis. Armed with this knowledge and the support of shareholders and employees throughout the company, Mr. Haines provides business decisions that aim at improving Westar's profitability.

Now consider that a commission composed of appointed officials, lacking the experience and knowledge specific to Westar's management, second-guesses Mr. Haines's managerial decisions and stipulates how Westar will finance its business. Originally implemented to protect the public from rate increases, this commission slowly usurps the role of Westar's executives and begins to effectively "manage" portions of Westar's electric business.

The scenario just presented is occurring in some form on a day-to-day basis in almost every state and is threatening the autonomy of management in the public utility industry. In the wake of Enron, WorldCom, and the California energy crisis, business decisions are viewed with great skepticism.[1] As a consequence of this heightened scrutiny, public utility companies like Westar are increasingly subjected to more intrusive regulation than ever before in an effort to protect the best interests of the public. Furthermore, public utility commissions (hereinafter referred to generally as "commissions"), originally designed to prevent unconscionable rate increases, have started to

1. *See* Rebecca Smith, *Shock Waves: Enron's Swoon Leaves a Grand Experiment in a State of Disarray*, WALL ST. J., Nov. 30, 2001, at A1 (describing the uncertainty in the energy market since the fall of Enron and the California energy crisis). California was the first large state to deregulate its electricity market, and since this time, prices have spiked higher than forty percent, and there have been a series of intermittent blackouts. *Id.* General Electric Co. Chairman and Chief Executive Jeffrey Immelt recently spoke to shareholders in the wake of the Enron collapse and described the widespread uncertainty in today's market that has lead to the increased skepticism of public utility companies. Rachel Emma Silverman, *GE's Immelt Says Lowered Stock Price Upsets Him, Too*, WALL ST. J., Apr. 25, 2002, at A6. "We live in a new age," he stated. *Id.* "Performance is not enough. When a trillion or so in New Economy market cap goes up in smoke. When advisers rate a stock a 'buy' and it goes bankrupt a couple weeks later. When the system designed to provide confidence in the numbers falls apart. It changes things." *Id.*

exude greater control over the internal operations of public utilities. In order to effectively balance a commission's goals and those of a public utility, courts must develop a usable test that can be uniformly applied.

Regulatory bodies are generally viewed as beneficial to the public, but many people fail to realize the entire scope of their impact on ratepayers, and subsequently on the economy. When public utilities suffer from tight control and a restriction of management's judgment, the ratepayers can be inadvertently harmed. Corporate budgets are restricted, maintenance and construction are reduced, people lose their jobs, and the utility industry suffers due to the increased regulation by commissions.[2] The United States Supreme Court has stated: "It must never be forgotten that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and is not clothed with the general power of management incident to ownership."[3] State courts have followed this directive. For example, the Supreme Court of Wyoming announced: "Not only is the participation by a state agency in a utility's business decisions unnecessary to regulation, it is impermissible."[4]

From this rationale emerged what is commonly referred to as the "Invasion of Management" defense. While this defense recognizes that regulatory commissions have authority to protect ratepayers from rate hikes, it also limits commissions' power. In its simplest form, the Invasion of Management defense prevents commissions from inhibiting expansion, acquisitions, and financing options that are viewed by management as necessary business activities.[5]

In *Mountain States Telephone and Telegraph Co. v. Public Service Commission*,[6] the Supreme Court of Wyoming recognized that some courts were starting to restrict the Invasion of Management defense. The court explained that "in *General Telephone Company of California v. Public Utilities Commission* the court said 'that the "invasion of management" rationale now appears to be disfavored' because judicial limitations were increasingly imposed upon what once had been perceived as within 'management functions' of utilities."[7]

2. The utilities industry employed 666,200 people in 1995, however, this figure has declined to 570,200 in 2004. U.S. DEPT. OF LABOR, BUREAU OF LABOR STATISTICS, INDUSTRY AT A GLANCE: NAICS 48-49 & 22: TRANSPORTATION AND WAREHOUSING, AND UTILITIES, *available at* http://www.bls.gov/iag/transportutil.htm (last visited Mar. 23, 2006).

3. Missouri *ex rel.* Sw. Bell Tel. Co. v. Pub. Serv. Comm'n, 262 U.S. 276, 289 (1923).

4. Pac. Power & Light Co. v. Pub. Serv. Comm'n, 677 P.2d 799, 810 (Wyo. 1984) (Rose, J., specially concurring).

5. *See id.* at 807–09 (majority opinion).

6. 745 P.2d 563 (Wyo. 1987).

7. *Id.* at 569 (quoting 670 P.2d 349, 354 n.10 (Cal. 1983)) (internal citation omitted).

However, Wyoming's high court went on to conclude that

> [t]his prognostication by the Supreme Court of California may not be entirely accurate. It does not cognize a rather delicate but definite line that must be drawn between regulated but free enterprise and socialization. Free enterprise assumes the responsibility of management to investors for management's decisions. Permitting civil servants to make those determinations instead of management results in no accountability for those decisions to investors in the business. That is not compatible with even regulated monopolies in a free enterprise system. We prefer the view heretofore espoused that extensions of power by judicial construction beyond that conferred upon an agency by the legislature, either specifically or generally, is inappropriate because:
>
> "*An administrative board has no power or authority other than that particularly conferred upon it by statute or by construction* necessary to accomplish the aims of the statute."[8]

This Comment will explain why the Invasion of Management defense is not extinct and illustrate how it serves as a more doctrinally sound approach to interpreting how far a public utility commission's power extends. To do so, this Comment will first analyze the composition of public utility companies and the role the Invasion of Management defense plays in preserving this structure. Next, this Comment will take a look at some of the important opinions throughout history that have shaped and defined the Invasion of Management defense. Finally, this Comment will walk through a recent Federal Energy Regulatory Commission (FERC) order and analyze the present and future application of the Invasion of Management defense to this decision.

I. THE STRUCTURE OF PUBLIC UTILITIES AND DEVELOPMENT OF THE INVASION OF MANAGEMENT DEFENSE

The United States operates under a free-market economy. In its purest form, market forces (supply and demand) and governmental regulation determine the level of output and the ultimate price of goods. Business in the United States has long operated under this framework, with management tailoring its competitive decisions to this model. Moreover, "[e]conomists and other policy experts around the world are increasingly skeptical about the necessity and effectiveness of government regulation and more confident in free market forces."[9] With this in mind, it is important to first describe how the government regulates public utilities. Then, it will be easier to see why there is a movement toward opening the electric utility industry to the benefits

8. *Id.* (emphasis added) (quoting Tri-County Elec. Ass'n. v. City of Gillette, 525 P.2d 3, 9 (Wyo. 1974)).

9. Laura R. Starling, Comment, *Don't Be Shocked! Electric Utility Deregulation Can Benefit Low-Cost States*, 74 TUL. L. REV. 1519, 1525 (2000).

of a free market economy and greater competition among industry participants.[10]

The major sectors of the economy are composed of private and government businesses. There is, however, another form of business that is a hybrid of these, upon which this Comment focuses: public utilities.

> Because a state may, under the police power, regulate a business affected with a public interest, and because the prime characteristic of a public utility is that of public use or service, a state may regulate and control a public utility to protect the public interests and to promote the health, comfort, safety, and welfare of the people.[11]

Pursuant to the Federal Power Act,[12] the United States possesses the right to regulate public utilities.[13] The right of states to regulate private companies that affect the public is also a creation of legislature and was affirmed in *Munn v. Illinois* in 1876.[14] Public utilities are subject to regulation and afforded financial safeguards because of the unique position they occupy in business. Because of the monopolistic characteristics of their business,[15] and the simple

10. *See id.*

11. 64 AM. JUR. 2D *Public Utilities* § 15 (2005). It is at the legislature's discretion to decide what interests are to be promoted and what measures serve to promote these interests. *Id.* While the state can control the manner in which utilities conduct their business, they cannot control the manager of the utility. *Id.* "In the absence of a clear and lawful limitation, a regulated public utility has all the rights granted by, and the duties imposed by, general law." *Id.* § 13.

12. 16 U.S.C. §§ 791a–825r (2000).

13. *E.g.*, *id.* § 824(a).

> It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

Id. While this section limits federal power to those areas not subject to regulation by the states, it also applies "to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce." *Id.* § 824(b).

14. 94 U.S. 113 (1876); *see, e.g.*, OKLA. CONST. art. 9, § 18 (The Commission shall have the power and authority and be charged with the duty of supervising, regulating and controlling all transportation and transmission companies doing business in this State, in all matters relating to the performance of their public duties and their charges therefor . . . .").

15. Joan G. Fickinger, Comment, *Jurisdiction of State Regulatory Commissions Over Public Utility Holding Company Diversification*, 15 LOY. U. CHI. L.J. 87, 89 n.12 (1983) (citing C. WILCOX & W. SHEPHERD, PUBLIC POLICIES TOWARD BUSINESS 334 (5th ed. 1975)). Public utilities can be divided into two categories of competitiveness: "monopolies" (consisting of telephone, electric power, natural gas, and sewage companies) and "partially competitive" companies (consisting of railroads, pipelines, and cable providers). *Id.*

fact that electricity is different from deregulated businesses, policy favors preventing rather than promoting competition among public utilities.[16]

"[A] natural monopoly is a situation where a single company tends to become the only supplier of a product or service over time because the nature of that product or service makes a single supplier more efficient than multiple, competing ones."[17] In other words, companies like public utilities take advantage of economies of scale and markets that are particularly expensive to enter. These advantages are formed in the utility industry because "the average cost of providing electricity falls as output increases."[18] As a result, policy favors regulating these monopolies rather than subjecting them to potentially destructive competition.[19]

Electric utilities are generally composed of three sectors: generation, transmission, and distribution.[20] Historically, there have been vertically integrated utilities (generation, transmission, and distribution), generation and transmission (G&T) utilities, and distribution companies (usually small cooperatives and municipal utilities).[21] Public utilities are privately owned, but are heavily regulated by state commissions and the FERC at the federal level.[22] The state and federal governments then define the limits of the commission's powers through statutory law.[23] In almost every state this power is restricted and only permits commissions to act when companies take actions that will affect rates.[24] However, in states like Kansas, regulatory commissions are also

16. Spencer Weber Waller, *Competition, Consumer Protection and Energy Deregulation: A Conference Introduction*, 33 LOY. U. CHI. L.J. 749, 754 (2002) ("Electricity is necessary for modern life. It has few reasonably effective substitutes, and it has a substantially inelastic demand curve making consumers vulnerable to price increases in times of shortage or when faced with exercise of market power.").

17. Ipedia, Internet Encyclopedia, http://www.ipedia.com/natural_monopoly.html (last visited Mar. 25, 2006).

18. Starling, *supra* note 9, at 1521. "For example, . . . once the utility company has incurred the fixed cost of stringing thousands of miles of lines, it costs less and less to serve additional customers." *Id.* at 1521–22. However, technological advances in the gas industry have allowed smaller gas-fired generating plants to produce energy more efficiently, and as a result, the monopolistic characteristics of the energy market have been eliminated to an extent. *Id.* at 1523.

19. Ipedia, *supra* note 17. Many groups have lobbied to be treated as natural monopolies to take advantage of stable prices, a reduced risk of competition, and a guaranteed return for shareholders. *Id.*

20. *Id*. at 1521.

21. *Id.* When all three functions are performed by a vertically integrated utility, the end product is traditionally sold as a single product to the consumer. *Id.*

22. Waller, *supra* note 16, at 754.

23. *See* Note, *"Management Invaded"—A Real or False Defense?*, 5 STAN. L. REV. 110, 111 (1952) [hereinafter *Management Invaded*].

24. *See, e.g.*, WYO. STAT. ANN. § 37-2-121 (1999) (empowering the commission to act when it determines a rate "to be inadequate or unremunerative, or to be unjust, or unreasonable, or unjustly discriminatory, or unduly preferential").

generally charged with ensuring that the utility provides "efficient and sufficient service," referring to both economic efficiency and reliability.[25]

Because commissions' power is delegated by the legislature, the commissions can only exercise the portion of police power that has been specifically delegated to them.[26] Statutory grants, however, often result in general grants of power, which incite interpretation problems for courts.[27] Because of these interpretation issues, troubles often arise when commissions attempt to restrict the operations of public utilities beyond the specific statutory grants of power to commissions. Beyond statutory limitations, commissions are also limited by constitutions.[28] The Federal Constitution is generally the basis for a constitutional challenge, since state constitutions rarely enter the cases.[29] Thus, commissions' attempts to over-regulate public utilities are

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25. KAN. STAT. ANN. § 66-101b (2002).

> Every electric public utility governed by this act shall be required to furnish reasonably *efficient and sufficient* services and facilities for the use of any and all products or services rendered, furnished, supplied or produced by such electric public utility, to *establish just and reasonable rates*, charges and exactions and to make just and reasonable rules, classifications and regulations. Every unjust or unreasonably discriminatory or unduly preferential rule, regulation, classification, rate, charge or exaction is prohibited and is unlawful and void. The commission shall have the power, after notice and hearing in accordance with the provisions of the Kansas administrative procedure act, to require all electric public utilities governed by this act to establish and maintain just and reasonable rates when the same are reasonably necessary in order to maintain reasonably sufficient and efficient service from such electric public utilities.

Id. (emphasis added).

26. *Management Invaded*, *supra* note 23, at 111.

27. *Id.* at 112–13.

28. *Id.* at 113.

29. *Id*. California expressly makes the legislature superior to their constitution, while other states approach the problem instead through federal means. *Id.*; *see also* CAL. CONST. art. 12, § 5.

> The Legislature has plenary power, unlimited by the other provisions of this constitution but consistent with this article, to confer additional authority and jurisdiction upon the commission, to establish the manner and scope of review of commission action in a court of record, and to enable it to fix just compensation for utility property taken by eminent domain.

Id. In Kansas, for example, "The commission is given full power, authority and jurisdiction to supervise and control the electric public utilities, as defined in K.S.A. 66-101a, doing business in Kansas, and is empowered to do all things necessary and convenient for the exercise of such power, authority and jurisdiction." KAN. STAT. ANN. § 66-101. While there have been numerous challenges to state commission rulings, these challenges have almost uniformly turned on the commissions' interpretations of their delegated authority, not the constitutionality of the commissions' orders. *See, e.g.*, Jones v. Kan. Gas & Elec. Co., 565 P.2d 597 (Kan. 1977); Cent. Kan. Power Co. v. State Corp. Comm'n, 561 P.2d 779 (Kan. 1977); Sekan Elec. Coop. Ass'n v. State Corp. Comm'n, 609 P.2d 188 (Kan. Ct. App. 1980).

occasionally viewed as an unlawful taking of property without due process,[30] or as an unlawful taking due to a lack of just compensation.[31] However, commerce clause and due process challenges are often applied non-uniformly and without clarity, and as a result, the Invasion of Management defense is most commonly confined to limitations intrinsic to the statutory grants themselves.[32]

With these limitations in mind, "[t]he legal issue [becomes] whether or not the commission has power to make the order"; in other words, "whether the subject of the order is the business of management or of regulation."[33] Therefore, whenever a commission restricts a decision that should have been properly left to management, courts label that intrusion an "Invasion of Management."[34] But the Invasion of Management defense is not just a way of classifying a statutory or constitutional violation; there are also limitations to the power of managerial regulation that *has* been assigned to commissions.[35]

Statutory power, in the form of general grants to commissions, clearly refers to regulatory power over services and facilities in the area of "direct contact" between the consumer and the utility.[36] It is in this area that the Invasion of Management rationale provides two limits on the power of commissions to regulate. First, commissions have the power to decide *what* services or facilities are available to the public, but not *how* these services or facilities are to be provided.[37] Second, a "convenience-necessity rule" has developed to limit commissions' power to regulate even if they are regulating in the area of *what* services or facilities are to be offered.[38] This is most commonly applied when a utility wishes to abandon services, and requires that the commission show *public necessity* to deny the utility permission to

30. *Management Invaded*, *supra* note 23, at 115 (citing Atl. Coast Line v. Corp. Comm'n, 206 U.S. 1, 20 (1907)).

31. *Id.* (citing Del. L. & W. R.R. v. Town of Morristown, 276 U.S. 182 (1928)).

32. *Id.* at 114–16.

33. *Id.* at 111.

34. *See id*.

35. *Management Invaded*, *supra* note 23, at 117. Courts often refer to limitations on regulation in excess of the constitutional limits provided in that state or by the Federal Constitution. *Id.* at 118.

36. *Id.* at 118. "Commission orders are uniformly upheld when the managerial decision 'invaded' is clearly within the area of direct consumer-utility contact." *Id.* at 119. For example, in *Southern Pacific Co. v. Public Utilities Commission*, 260 P.2d 70, 73 (Cal. 1953), part 2 of the order by the commission was not challenged as an Invasion of Management as it dealt with facilities in direct contact with the consumer. Part 2 ordered "[t]hat other trains of [Southern Pacific Company] ('The Senator' and 'The El Dorado') be 'refurbished to a standard comparable to modern, railway passenger equipment.'" *Id.* at 72.

37. *Management Invaded*, *supra* note 23, at 120.

38. *Id.* at 123.

abandon the service.[39] Whenever a commission oversteps one of these limits on its power to regulate, the commission has "invaded management." Thus, courts do draw lines within the limits specifically granted in statutes, but where this line is drawn between commissions and management is not always clear.[40] Over time, trends in the case law have been anything but consistent, and based on recent FERC decisions, commentators have recognized that "a clear trend is emerging toward heightened scrutiny of financial transactions involving public utilities and their nonutility parents and affiliates."[41] As a result, the Invasion of Management defense will often be implicated in situations involving affiliates of electric companies. The effects of this situation will be explored in depth in the *Westar* case outlined in this Comment.

II. OPINIONS SHAPING THE INVASION OF MANAGEMENT DEFENSE

A. *Developing the Prongs of the Defense*

As early as 1923, the Supreme Court of the United States recognized that certain areas of a public utility's business were reserved for management. In *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, the Public Service Commission of Missouri (the "Missouri Commission") directed Southwestern Bell Telephone Company (SBC) to reduce its service rates and to eliminate its charges for installation and moving expenses.[42] SBC produced evidence as to the valuation of its property to show the Missouri Commission that its charges were warranted.[43] Independent valuations also revealed that the Missouri Commission's valuations were substantially lower than actual market value.[44] As a result, the United States Supreme Court overruled an earlier judgment for the Missouri Commission and held that it was not warranted in disallowing an installation charge because management had the right to exercise its discretion.[45]

The Court explained that "[i]t must never be forgotten that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and is not clothed with the general power of management incident to ownership."[46] The Court went on to emphasize that "the [Missouri Commission] is not the financial manager

39. *Id*.
40. *See id.* at 117.
41. Teresa B. Salamone et al., *Increased FERC Scrutiny of Financing Activities by Public Utilities*, 18 NAT. RESOURCES & ENV'T, Summer 2003, at 28, 31.
42. 262 U.S. 276, 282 (1923).
43. *Id.*
44. *See id.* at 288.
45. *Id.* at 288–89.
46. *Id.* at 289.

of the corporation, and it is not empowered to substitute its judgment for that of the directors of the corporation . . . ."[47]

Even though the Missouri Commission was regulating rates in *Missouri* ex rel. *Southwestern Bell*, the Supreme Court found that there were limits on its power beyond those specifically provided in statutes. Furthermore, while this decision was not cast in Invasion of Management language, it would serve as a building block for future utilities arguing that their managerial autonomy had been invaded. Since this decision, actions by commissions have strayed well beyond simply regulating rates, and have thus evoked greater concern that they are beyond a public utility commission's prescribed powers.

After the *Missouri ex rel. Southwestern Bell* decision, more than twenty-five years passed without any significant decisions in this area. Although decisions were handed down restricting commission power, there were no egregious intrusions on management's power. But then, in 1950, the Supreme Court of California set the standard for what is now referred to as the Invasion of Management rationale in its *Pacific Telephone & Telegraph Co. v. Public Utilities Commission*[48] decision.

In *Pacific Telephone*, two orders by the Public Utilities Commission of the State of California (the "California Commission") were challenged as usurping the functions of internal management.[49] American Telephone and Telegraph Company (AT&T) owned almost ninety percent of Pacific Telephone and Telegraph Company's (PT&T) capital stock, and received one percent of PT&T's gross receipts for its services regularly provided to PT&T.[50] The California Commission viewed this as an exaction by a more powerful AT&T company and ordered that each transaction be viewed individually and that AT&T be paid only for specific services provided for that particular transaction.[51] PT&T recognized that the California Commission could prevent payments that it viewed as excessive, but argued that the California Commission was without power to usurp management's role by prescribing contract terms for them.[52] At the time, California had not expressly granted the California Commission the power to regulate payments between an operating utility and its affiliated parent company, so the court looked to determine if any

47. 263 U.S. at 289 (quoting States Pub. Utils. Comm'n *ex rel.* Springfield v. Springfield Gas & Elec. Co., 125 N.E. 891, 901 (1920)).

48. 215 P.2d 441 (Cal. 1950).

49. *Id.* at 442.

50. *Id.*

51. *Id.* Specifically, the order required that only reasonable costs be paid to AT&T, determined by what it would actually cost AT&T within its own organization. *Id.* Furthermore, PT&T was required to file bimonthly reports explaining any transactions with AT&T and to avoid exceeding a $2,250,000 annual basis without approval from the California Commission. *Id.* at 442–43.

52. *Id*. at 443.

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

statutes currently granting the California Commission power would allow this order.[53]

The Public Utilities Act of California served two broad purposes: (1) it allowed the California Commission to regulate the service and rates between the consumer and the utility, and (2) it required commission approval of either the sale or encumbrance of property and the issuance of new securities.[54] However, the court pointed out that the Act did not provide the California Commission with the "power to regulate the contracts by which the utility secures the labor, materials, and services necessary for the conduct of its business, whether such contracts are made with affiliated corporations or others."[55] The California Commission was not permitted to regulate areas that were not impressed with direct contact between the utility and the consumer, such as affiliate contract terms.[56]

The court began by recognizing that almost every contract a public utility enters into will affect its rates in one way or another.[57] However, the court went on to emphasize that "[t]he determination of what is reasonable in conducting the business of the utility is the primary responsibility of management."[58] Furthermore, the court found that if the California Commission is able to substitute its judgment for that of management in contract making and the general business of utilities, then it is able to assume management of all utilities in its jurisdiction.[59] The court noted that even if management were derelict in its duties, the law does not justify taking away control of the company or vesting ownership with the public simply because the company is a regulated "public" utility.[60]

The court then went through a brief history of instances where courts prevented commission intervention, explaining that other courts using statutes similar to those in California only allow contract modification where the contract impacts rates and services directly.[61] Although precedent in the area

53. *Pac. Tel. & Tel. Co.*, 215 P.2d at 443–44. At this time, many state legislatures had enacted statutes to protect consumers from potential abuses that could occur between a utility and its parent company. *See Legislation*, 49 HARV. L. REV. 957, 982–89 (1936) (analyzing states' regulation of service contracts).

54. *Pac. Tel. & Tel. Co.*, 215 P.2d at 444.

55. *Id*.

56. *Id*.

57. *Id*. at 445.

58. *Id*.

59. *Pac. Tel. & Tel. Co.*, 215 P.2d at 445.

60. *Id*.

61. *Id.* The court noted that previously, in *Hollywood Chamber of Commerce v. Railroad Commission*, the court held that the Railroad Commission could not require the Hollywood Chamber of Commerce to discontinue paying dividends to expand into profitable fields that the utility was not currently involved in, since it was properly management's choice. *Id*. (citing 219 P. 983 (Cal. 1923)). Along the same lines, the court cited *Southern Pacific Co. v. Railroad*

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

was not strong yet, the court elected to emphasize the need for direct contact between the utility and the consumer in order for a commission to permissibly intervene in management's decisions.[62]

Therefore, with the limited precedent before it, the court reiterated that the contract between PT&T and AT&T was not hampering the plaintiff's service to the public.[63] The court explained that the situation was no different than any other where management disagrees with a commission on the profitability of an expenditure, but decides to go forward with the expenditure, even though it cannot recover the costs from ratepayers should it prove unprofitable.[64] Based on this reasoning, the court effectively outlined the first part of the Invasion of Management rationale: In order to regulate, a commission must be dealing with an area impressed with direct utility–consumer contact. Future litigation between commissions and public utility companies would invoke *Pacific Telephone*'s framework in part or in whole for many years to come.[65]

The next several years provided few "landmark" decisions, yet these decisions were important in further developing a framework for analyzing problems between commissions and public utility companies. Three years after *Pacific Telephone*, the Supreme Court of California issued an opinion that commissions would cling to for a number of years. In *Southern Pacific Co. v. Public Utilities Commission*,[66] the court affirmed the Public Utilities Commission's order directing Southern Pacific Company to substitute modern railway passenger cars for its outdated steam locomotives.[67] The court did not make a single mention of *Pacific Telephone*, but responded to the Invasion of Management argument by stating that the language of sections 730, 761, 762, and 763 of the California Public Utilities Code specifically authorized the commission's order.[68] Although commissions interpreted this opinion as

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Commission, which found that there is a "zone of reasonableness" within which management is allowed to prescribe its own rates. *Id.* (citing 87 P.2d 1055, 1070 (Cal. 1939)). The court noted that other courts using statutes similar to those in California allowed contract modification only where the contract impacted rates and services directly. *Id.*

62. *See id.* at 445–46.

63. *Id.* at 447.

64. *Pac. Tel. & Tel. Co.*, 215 P.2d at 447.

65. *See, e.g.*, Gay Law Students Ass'n v. Pac. Tel. & Tel. Co., 595 P.2d 592, 604 n.11 (Cal. 1979); Credit Ins. Gen. Agents Ass'n v. Payne, 547 P.2d 993, 997–98 (Cal. 1976); Stepak v. Am. Tel. and Tel. Co., 231 Cal Rptr. 37, 40–43 (Cal. Ct. App. 1987); Gen. Tel. Co. v. Lundy, 218 N.E.2d 274, 277 (N.Y. 1966). Even though *Pacific Telephone* has been criticized in recent years, it has withstood judicial scrutiny to the present day.

66. 260 P.2d 70 (Cal. 1953) (en banc).

67. *Id.* at 72, 79.

68. *Id.* at 78.

> [The Sections] empower the commission to "determine the kind and character of facilities and the extent of the operation thereof, necessary reasonably and adequately to meet public requirements for services furnished by common carriers." By Section 761 it is

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

broadening their general grants of statutory power, the opinion actually only reinforced the principles inherent in the Invasion of Management rationale. In other words, management is prohibited from complaining when a commission prescribes *what* services or facilities a utility can provide and acts in accordance with specific statutory grants.

Several years after this opinion, other courts began to build on the *Pacific Telephone* and *Southern Pacific Co.* opinions and recognize that commissions could not prescribe *how* services were to be provided even in areas of direct consumer contact. In *Rhode Island Consumers' Council v. Smith*,[69] the Rhode Island Public Utilities Commission directed a utility to include a one-dollar per month discount for senior citizens (65 years or older) in any new tariff that the utility added to its rates.[70] The court noted that while management is allowed to classify a gift as an operating expense in certain situations, courts have never authorized public utility commissions to "invade management's province by directing a utility to make a charitable contribution."[71] Thus, the Supreme Court of Rhode Island found that commissions could not regulate rates that were lawfully established.[72] As the courts had already determined in *Southern Pacific Co.*, commissions are only permitted to regulate *what* services and facilities a utility provides to its consumers, not *how* the services are provided.

The cases that followed *Smith* in the next nineteen years added little to Invasion of Management jurisprudence. However, in 1984, courts around the country again began to embark on decisions cast in this language. The modern Invasion of Management jurisprudence has expanded commissions' power somewhat as courts are erring on the side of over-regulation. Even so, courts have not provided commissions with unbridled control over the operations of a utility. A 1984 decision from the Supreme Court of Wyoming made it clear that courts concentrate on one more issue in determining whether a commission has invaded management's prerogative.

In *Pacific Power & Light Co. v. Public Service Commission*,[73] the Public Service Commission of Wyoming (the "Wyoming Commission") determined that losses in a nuclear power construction project should be borne by the stockholders of Pacific Power & Light Company (PP&L) and not by the

> provided that whenever the commission, after a hearing finds that the equipment of the utility is inadequate it shall determine and by order require the proper equipment to be employed. Section 762 contains language to similar effect. And Section 763 authorizes the commission, upon hearing and findings, to require adequate train services as to time schedules, equipment and transportation facilities.

Id. (internal citation omitted).

69. 302 A.2d 757 (R.I. 1973).
70. *Id*. at 775.
71. *Id*.
72. *Id*.
73. 677 P.2d 799 (Wyo. 1984).

consumers.[74] The court explained that the decision to undertake the project was that of management and the representatives of PP&L after calculating the risk and possible return.[75] Moreover, there would be no risk at all to PP&L if the consumers were to bear the loss, and PP&L would thus undertake projects that had even a very small chance of success.[76] The majority reasoned, therefore, that consumers could not bear the risk of a faulty project unless PP&L obtained approval from the Wyoming Commission prior to undertaking the project.[77] The Supreme Court made it clear that this decision was justified because there was a *public necessity* to prevent the utility from imposing the costs of an unsuccessful project on the public.[78] Thus, the Supreme Court of Wyoming established the final prong of the Invasion of Management defense: a commission wishing to prevent utility action (here, imposing the costs of a failed project) must show a public necessity, rather than public convenience, to deny the utility permission to perform the action.

B. Modern Decisions Defining the Limits of the Invasion of Management Defense

Two years after the final prong of the Invasion of Management defense was established in *Pacific Power and Light Co.*, the California courts returned to their jurisprudence in this area and restricted a decision they had handed

74. *Id.* at 806.

75. *Id*.

76. *Id*.

77. *Id*. at 808–09. *But see id*. at 809–11 (Rose, J., specially concurring) (explaining that permitting the utility to recover its investments in terminated projects if the proposal was first submitted to the commission would exceed the scope of the statute).

78. *Pac. Power & Light Co.*, 677 P.2d at 808–09. At about the same time, a similar decision was handed down in Pennsylvania. In *Duquesne Light Co. v. Pennsylvania Public Utility Commission*, the court again sided with a commission, but reiterated the most important boundary regulating decisions in this area. 507 A.2d 1274 (Pa. 1986). The court cited the Pennsylvania Public Utility Code, stating that "[i]t is a fundamental principle of public utility law that a utility may not recover costs from its ratepayers unless such costs have been determined to be just and reasonable." *Id*. at 1278. However, the court stated that while the Pennsylvania Public Utility Commission (the "Pennsylvania Commission") had power to regulate utilities when their conduct affected the public, the Commission's power to insert itself into the role of management was restricted, unless there existed a public necessity. *Id.* With the Code's language in mind, the Court found that the Pennsylvania Commission could establish a mine price cap formula for determining market price, because the costs of coal were being directly passed on to the consumers. *Id*. at 1279–81. The coal mine that Duquesne Light Company ("Duquesne") had developed some years back was producing coal at cost higher than local prices. *See id*. at 1281. While the Pennsylvania Commission allowed the recovery of some deferred costs, it did not permit full recovery since Duquesne's management chose to undertake the project. *Id*. Consequently, the court seemed to proffer a basic rule: commissions can only regulate in an area that protects consumer interests when there is a possibility of increased rates. *See id.* at 1278.

down only three years earlier.[79] In *Stepak v. American Telephone and Telgraph Co.*,[80] AT&T owned over ninety percent of the voting shares of PT&T, while Stepak (an individual shareholder) owned some of the remaining shares.[81] In 1981, PT&T applied with the Public Utility Commission (PUC) to merge with a subsidiary of AT&T and eliminate all minority voting power in PT&T.[82] The PUC approved the merger, and as a result, AT&T gained complete voting control in the merged companies.[83] In the process, the PUC likened the minority shareholders to ratepayers, but found that their interests would not be adversely affected because they were receiving a fair price for their shares.[84]

On appeal to the California Court of Appeal, First District, Stepak first challenged the jurisdiction of the PUC to adjudicate issues regarding minority shareholders.[85] Likening the current case to *Pacific Telephone*, the court found no power, granted or implied, that allowed the PUC to decide whether the merger was fair to minority shareholders, and it concluded that the PUC did not have jurisdiction to make this determination and that the minority shareholders had a legitimate claim.[86]

The California Supreme Court, in *General Telephone Co. v. Public Utilities Commission*,[87] then discussed the recent language limiting the Invasion of Management rationale.[88] There the court explained that the *Pacific Telephone* decision and the Invasion of Management rationale had been cast into doubt, noting the decisions in *Southern Pacific Co. v. Public Utilities Commission*[89] and *Atchison, T. & S. F. Ry. Co. v. Railroad Commission*[90] as support for this proposition.[91] Therefore, the California Supreme Court, drawing support from various Public Utilities Code provisions, rejected

79. As more recent decisions have indicated (as discussed *infra* in this section), California has developed this area of law more than any other state, and this decision would once again instill life into proponents of the "management invaded" defense.

80. 231 Cal. Rptr. 37 (Cal. Ct. App. 1986).

81. *Id.* at 38.

82. *Id.*

83. *Id*. at 39.

84. *Id*.

85. *Stepak*, 231 Cal. Rptr. at 40.

86. *Id.* at 40–42.

87. 670 P.2d 349 (Cal. 1983).

88. *Id.* at 352–56.

89. 260 P.2d 70 (Cal. 1953) (en banc) (discussed *supra* in text accompanying notes 66–68).

90. 288 P. 775, 779 (Cal. 1930) (holding that the commission's order requiring the construction of a new terminal was supported by numerous statutory provisions).

91. *Gen. Tel. Co.*, 670 P.2d at 353–54. However, the court was quick to note that "*Atchison* and *Southern Pacific* can, of course, be distinguished from *Pac. Tel.* in that they deal directly with the commission's power over service," emphasizing that it still considered the defense to be disfavored. *Id*. at 354 n.10.

General Telephone Company's argument.[92] The court explained that unlike *Pacific Telephone*, the commission in *General Telephone Co.* was only trying to provide better service and thus regulate the direct "relationship of the utility to the consumer."[93]

With this precedent in mind, the *Stepak* court opined that "the 'invasion of management rationale,' while near terminal 'in the area of "direct consumer-utility contact,"' has life in areas *other than* direct consumer-utility contact."[94] Because Stepak's actions had no effect on rates or services in this case,[95] the Invasion of Management rationale applied to limit the PUC's power in areas without direct contact between consumers and the utility.[96] Thus, while it was clear that commissions could regulate areas impressed with direct consumer–utility contact, it was uncertain whether courts would speak of the *how/why* distinction and *public necessity/convenience* prongs of the defense in the future.

Less than one year later, a Wyoming Court would be the first to recognize that the Invasion of Management rationale had not deteriorated, setting the stage for a continued revival of the defense over the next several years.

In the case of *In re Mountain States Telephone and Telegraph Co.*,[97] the Wyoming Commission ordered Mountain States Telephone and Telegraph Company (MST&T) to rescind a recent transfer of its directory publishing division to its sister corporation and instead submit its directory publication to competitive bidding.[98] The court, however, held that there was not a sufficient "connection between the revenue produced by the directory publishing service and the rates that [MST&T] ultimately charged for those services which are furnished 'to or for the public'" for the Wyoming Commission to exercise jurisdiction over MST&T's business transaction.[99]

In reaching its decision the court reiterated its own language just three years earlier in *Pacific Power and Light*: "[A commission] is not in a position to take on any aspect of utility management. It must restrict its position to

92. The court noted that sections 701, 728, and 761 of the California Public Utility Code were "ample to sustain the challenged order." *Id.* at 356.

93. *Id*. at 353. Consequently, while the court noted that the Invasion of Management defense had been cast into doubt, it still based its decision within the parameters of the defense. *See id.* at 353–55.

94. Stepak v. American Telephone & Telegraph Co., 231 Cal. Rptr. 37, 43 (Cal. Ct. App. 1987) (quoting *Gen. Tel. Co.*, 670 P.2d at 356) (internal citations omitted).

95. According to the court, "[The PUC] in this case expressly concluded that . . . the merger would *not* have any direct effect on the terms, conditions or cost of service provided to California ratepayers," since the PUC instituted an additional protective measure to offset ratemaking adjustments. *Id*. at 43.

96. *Id*.

97. 745 P.2d 563 (Wyo. 1987).

98. *Id.* at 564.

99. *Id.* at 570.

'regulation' with management decisions being entirely that of the utility."[100] While the court recognized the recent language in *General Telephone*, stating that "the 'invasion of management' rationale now appears to be disfavored,"[101] the court went on to conclude that "[t]his prognostication by the Supreme Court of California may not be entirely accurate."[102] Statutes give the Wyoming Commission its only power, the court continued, and in this instance the Wyoming Commission had no support for its actions.[103] Furthermore, in this case the utility was acting as a private entity, and as such, the Wyoming Commission acted beyond its jurisdiction in ordering *how* MST&T was to outsource its directory-publishing division.[104]

Modern proponents of deregulation and restricting commission interference rest much of their rationale on this decision. The court rebuked language limiting the Invasion of Management defense that California courts had proffered a year earlier, and reopened the door for this defense to public utility companies across the United States. The Invasion of Management defense again required that commissions only regulate areas impressed with direct consumer–utility contact, and even within this area, commissions could only regulate *what* services were to be provided.

While recent decisions continue to reflect this rejuvenation of the defense, other courts continue to uphold commission decisions that involve direct contact between the consumers and the utility. In *Arizona Corp. Commission v. State ex rel. Woods*,[105] for example, the Attorney General of Arizona refused to certify three rules proposed by the Arizona Corporation Commission (the "Arizona Commission") giving it governance over transactions between public utilities and their affiliates.[106] The Arizona Commission's proposed rules included (1) definitions, (2) reporting requirements, and (3) approval provisions.[107] The latter two requirements were challenged by the Attorney

100. *Id.* at 568 (quoting 677 P.2d 799, 807 (Wyo. 1984)).
101. *Id.* at 569 (quoting 670 P.2d 349, 354 n.10 (Cal. 1983)).
102. *In re Mountain States Tel. and Tel. Co.*, 745 P.2d at 569.
103. *Id.* at 571.
104. *See id.* at 569, 571.
105. 830 P.2d 807 (Ariz. 1992) (en banc).
106. *Id.* at 808.
107. *Id.* at 810.

> The [reporting requirements] require notice from any utility or affiliate intending to organize or reorganize a public utility holding company. The notice must disclose specific information regarding the proposed holding companies: the officers and directors and their business purposes, various financial and organizational information, diversification plans, and anticipated changes in the utility's costs and services. The informational rules also permit the Commission to gain access to an affiliate's books and records regarding its transactions with a public utility. Finally, the rules require annual reports from utilities and their holding companies regarding diversification plans and business activities between affiliates and the utility.

General of Arizona on behalf of more than twenty different state utility companies.[108]

The court began by looking at the historical background of the commission, finding that several ideological groups at the Arizona Constitutional Convention of 1910 "shared a strong distrust of corporate powers," and joined forces to promote a strong commission.[109] The Arizona Constitution also seemed to give more extensive power to the Arizona Commission than the Virginia and Oklahoma constitutions, even though Arizona's constitution was patterned after these states' constitutions.[110] The court then looked to precedent in this area and concluded "that the Commission has no regulatory authority under [the constitution] except that connected to its ratemaking power," but that deference must be afforded to the Commission to determine which regulations are necessary to protect rates.[111] The Court ultimately found that the Arizona Commission must be given the power to prevent transactions in advance in order to protect ratepayers from potential losses.[112]

In a similar decision, the Supreme Court of New Mexico supported a commission's decision preventing a utility from implementing tariffs to fund "optional service" programs.[113]The optional service programs would have allowed the utility to provide to its customers utility-related services that were not part of the utility's essential gas or utility business.[114] The court recognized that while a commission's regulation of public utilities is limited, it

> The approval rules require utilities to obtain Commission approval of the organization or reorganization of utility holding companies. These rules also require Commission approval of transactions by which utility corporations acquire or assume any financial interest in, or liabilities of, certain affiliates, lend to those affiliates, or use utility funds to form a subsidiary.

Id. (internal citations omitted).

108. *Id.*

109. *Id.* at 811–12. "As one influential framer, Michael Cunniff, argued, 'in almost every state . . . corporations have altogether too much influence in the [state's] direction and control.'" *Id.* at 812 (quoting JOURNAL OF THE CONSTITUTIONAL CONVENTION OF ARIZONA 435 (Cronin comp. 1925), *quoted in* John D. Leshy, *The Making of the Arizona Constitution*, 20 ARIZ. ST. L.J. 1, 89–90 (1988)).

110. *Ariz. Corp. Comm'n*, 830 P.2d at 812.

111. *Id.* at 815. "While diversification may be a wise financial decision for utility companies in some or even most instances, many critics 'fear that financial improvement through *unregulated* diversification will come at the expense of utility ratepayers.'" *Id.* at 817 (quoting Fickinger, *supra* note 15, at 95).

112. *Id.* at 818.

113. *In re* Application of PNM Elec. Servs., A Div. of Pub. Servs. Co. of New Mexico v. New Mexico Pub. Util. Comm'n, 961 P.2d 147, 152 (N.M. 1998).

114. *Id.* at 148–49.

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

was permissible in this case because substantial evidence showed that the program would pose risks to rates.[115]

In re Application PNM Electric Services seems to permit a commission to regulate an area not involved with direct contact between the consumer and the utility. Therefore, this opinion has been cited in numerous cases and secondary sources to support commission intervention.[116] In reality, however, Arizona now adheres to a broader construction of commission power than other jurisdictions, making it unlikely that an invasion of management argument would prove successful Arizona.[117]

Other states, however, still adhere to the framework intrinsic to invasion of management principles. For example, in *Public Service Co. v. State ex rel. Corp. Commission*,[118] the Oklahoma Corporation Commission (OCC) filed a rule change to close what they viewed as a "loophole" in Rule 60, which allowed some electric consumers to switch suppliers without cost.[119] To prevent the loophole, the OCC changed the word "consumer" to "electric consuming facility."[120] With this change, people who could once move into a new apartment and choose an electric supplier without cost were now required to either maintain the previous renter's electric provider or pay the changeover cost.[121] The Public Service Company of Oklahoma (PSC of Oklahoma) urged that this requirement should be eliminated because the costs of switching are often prohibitive to the consumer, and thus, did not allow consumers to choose their electric provider.[122]

The PSC of Oklahoma further argued that this constituted interference with internal management decisions, and as such, was not permitted by the

115. *Id.* at 153.

116. *See, e.g.*, State *ex rel.* Sandel v. N.M. Pub. Util. Comm'n, 980 P.2d 55, 60 (N.M. 1999); Martinez v. N.M. State Eng'r Office, 9 P.3d 657, 662 (N.M. Ct. App. 2000); 73 C.J.S. *Public Administrative Law and Procedure* § 106–07 (2004); Judy Sheldrew, *Shutting the Barn Door Before the Horse Is Stolen: How and Why State Public Utility Commissions Should Regulate Transactions Between a Public Utility and Its Affiliates*, 4 NEV. L.J. 164, 170 (2003).

117. *See, e.g.*, *In re Application of PNM Elec. Servs.*, 961 P.2d at 151–52.

118. 918 P.2d 733 (Okla. 1996).

119. *Id.* at 734, 736.

Rule 60 provides the procedure which must be utilized by a consumer, having available two or more electric suppliers, to switch from one supplier to another. In the event of such a switch by the consumer, the rule requires that the costs be paid to the replaced supplier by the acquiring supplier. The acquiring supplier is then forced, by Rule 60, to pass on the costs of the switch to the consumer.

Id. at 734.

120. *Id.* at 736.

121. *See id.*

122. *Id.* at 736, 738.

Oklahoma Constitution.[123] While the PSC of Oklahoma agreed that the OCC could protect the public's interest when regulating rates, it disagreed with the OCC's proposed interference into *how* the PSC of Oklahoma established new service.[124]

To resolve the issue, the court looked to prior authority, first citing *Missouri Pacific Railroad Co. v. Corp. Commission*[125] for its language constraining the authority of a commission: "[A commission] may regulate functions of corporations falling within its jurisdiction, only if the activity is impressed with public interest."[126] In other words, there must be direct contact between the consumer and the utility.

Next, the *Public Service* court considered *Oklahoma Gas & Electric Co. v. Corp. Commission*,[127] where the Oklahoma Supreme Court rejected the OCC's attempt to disallow the construction of a new generation station.[128] The court stated "the Constitution does not clothe [the OCC] with the general power of internal management and control incident to ownership," nor does it confer "either expressly or by necessary implication, the power to regulate, supervise and control the internal management and control of a public utility."[129] In effect, the court in *Oklahoma Gas & Electric Co.* found that there was no *public necessity* that would permit the OCC to intervene.

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123. *Pub. Serv. Co.*, 918 P.2d at 738. The court noted that the Oklahoma Constitution at Article 9, section 18, includes precise limitations on the OCC's authority directly bearing on the case at bar:

> The [OCC] shall have the power and authority and be charged with the duty of supervising, regulating and controlling all transportation and transmission companies doing business in this state, in all matters relating to the performance of their public duties and their charges therefor . . . and to that end the [OCC] shall, from time to time, prescribe and enforce against such companies, in the manner hereinafter authorized, such rates, charges, classifications of traffic, and rules and regulations, and shall require them to establish and maintain all such public services, facilities, and conveniences as may be reasonable and just . . . .

Id.

124. *Id.* at 739.

125. 672 P.2d 44 (Okla. 1983).

126. *Pub. Serv. Co.*, 918 P.2d at 739 (quoting *Mo. Pac. R.R. Co.*, 672 P.2d at 44). In *Missouri Pacific Railroad Co.*, the court held that a commission's order requiring railroads to provide lockers to their employees was not within the commission's authority. 672 P.2d at 45.

127. 543 P.2d 546 (Okla. 1975).

128. *Pub. Serv. Co.*, 918 P.2d at 739 (citing *Okla. Gas & Elec. Co.*, 543 P.2d at 551).

129. *Id.* (quoting *Okla. Gas & Elec. Co.*, 543 P.2d at 551–52). The court in *Oklahoma Gas & Electric Co.* concluded by quoting *Lone Star Gas Co. v. Corp. Commission*:

> The powers of the Commission are to regulate, supervise, and control the public service companies in their services and rates, but *these powers do not extend to an invasion of the discretion vested in the corporate management. It does not include* the power to approve or disapprove contracts about to be entered into, nor to *the approval or veto of expenditures proposed*.

Id. (quoting 39 P.2d 547, 552 (Okla. 1934)).

With this precedent in mind, the court turned to the instant case and explained that the OCC's order requiring consumers to bear changeover costs is impressed with direct contact between the consumer and the utility, but is contrary to precedent in that area because it dictates *how* new service will be established.[130] The court rationalized its decisions, stating that if a commission is concerned that switching costs borne by the utility will result in general rate increases, a commission should simply refuse the rate increase when the utility proposes it.[131] Consequently, as recently as 1996, the Supreme Court of Oklahoma has issued an opinion cast in the Invasion of Management rationale. As is often the case, however, this court did not explicitly call the commission order they overturned an "Invasion of Management," even though it adhered to the same rationale.

Thus, while the Invasion of Management defense continues to live on in most states, important questions continue to linger around the label itself. Whether the label will continue to be used is a question for future courts. However, this framework would have provided a more efficient way for the court to analyze the FERC's order in the *Westar* decision. For that matter, the Invasion of Management defense could prove to be a more efficient analysis for all courts who encounter similar issues of questionable regulation by public utility commissions.

III. WESTAR ENERGY'S PROPOSED BOND ISSUANCE

The FERC, in its recent *Westar* decision, imposed four new restrictions on any public utility's issuance of debt (secured or unsecured), and explicitly stated that "it is the Commission's intention that these restrictions will be applied to all future public utility issuances of secured and unsecured debt . . . ."[132] The FERC went on to "remind public utilities that section 204 [of the Federal Power Act (FPA)] gives the FERC Commission the authority to issue supplemental orders, and modify the provisions of any previous order . . . ."[133] The depths of this decision and its future implications encroach on areas of management formerly inaccessible to commission power. Before discussing the implications of this decision, however, one must understand the background against which it was decided.

A. Background

In September of 2002, Westar applied for authorization to issue long-term, unsecured debt in the amount of $650 million, in compliance with section

130. *See id.* at 740.
131. *Id.*
132. Westar Energy, Inc., 102 F.E.R.C. 61186, 61512 (2003), 2003 WL 732901.
133. *Id.* at 61512–13.

204(a) of the FPA.[134] Westar, pursuant to the FERC's request for additional financial information, filed details relating to its current debt load, future debt requirements, and reasons why the proposed issuances were in the public's best interest.[135] The Kansas Corporation Commission (KCC) and MBIA Insurance Company (MBIA) then filed motions to intervene in the FERC's proceedings.[136]

The KCC expressed concerns about Westar's financial situation, namely its capital structure and debt obligations.[137] Although the KCC made clear that it did not oppose Westar's potential debt issuance, it did emphasize that the issuance must be unsecured for the KCC's approval to remain intact.[138] MBIA, on the other hand, insured the bulk of Westar's bonds secured by the mortgage pledge of Westar and Kansas Gas and Electric Company (KG&E), a subsidiary of Westar.[139] MBIA stated that it had "become alarmed at . . . recent indications regarding troubling financial and management issues with Westar."[140] MBIA went on to recommend that the FERC exercise caution and

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134. *Id.* at 61510. The FPA section 204(a) is codified at 16 U.S.C. § 824c(a) and provides:

> No public utility shall issue any security, or assume any obligation or liability as guarantor, indorser, surety, or otherwise in respect of any security of another person, unless and until, and then only to the extent that, upon application by the public utility, the Commission by order authorizes such issue or assumption of liability. The Commission shall make such order only if it finds that such issue or assumption (a) is for some lawful object, within the corporate purposes of the applicant and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the applicant of service as a public utility and which will not impair its ability to perform that service, and (b) is reasonably necessary or appropriate for such purposes. The provisions of this section shall be effective six months after August 26, 1935.

16 U.S.C. § 824c(a) (2000).

135. *Westar Energy, Inc.*, 102 F.E.R.C. at 61510.

136. *Id.*

137. *Id.* There was an undertow at this time that Westar was mismanaged and swimming in debt due in large part to its unprofitable investment in unregulated subsidiaries such as Protection One. John Hanna, *Westar to Sell Non-utility Assets*, TULSA WORLD, Feb. 7, 2003, at E6 ("Critics have said Westar's investment in Protection One drained the company's finances, though Westar executives have maintained Protection One's management improved over the past two years, creating operating cash."). These concerns likely stemmed from a view that regulated utility customers were being forced to pay the higher cost of utility-secured debt associated with non-utility Westar affiliates. *See id.*

138. *Westar Energy, Inc.*, 102 F.E.R.C. at 61510.

139. *Id.*

140. *Id.* In its motion to intervene, MBIA went on to outline recent events that had created concern regarding Westar's financial strength. Motion to Intervene of MBIA Insurance Corporation at 3, Westar Energy, Inc., 102 F.E.R.C. 61186 (2003) (No. ES02-51-000). First, MBIA was concerned over the KCC's recent order requiring Westar to restructure its operations to protect ratepayers. *Id.* Next, several grand jury investigations into executive activities brought MBIA some anxiety. *Id.* Finally, MBIA was apprehensive of Westar's attempts to restructure in

seek out all appropriate information in considering Westar's proposal.[141] Thus, this notice of intervention served as the first sign that Westar's past managerial decisions were under consideration. Both the KCC and MBIA recommended intervention into the "troubling" management of Westar, evoking great concern from the FERC in a time shortly after the disasters associated with the Enron and WorldCom collapses.

The KCC then established additional requirements for Westar by filing two motions to lodge its orders with the FERC, detailing financial and corporate restructuring obligations.[142] The FERC did not allow Westar to answer the KCC's or MBIA's motions for intervention because good cause was not shown.[143] However, Westar did respond to the KCC's complaints, explaining that its proposed refinancing was in response to current debt that matured in the near future, and that "without the ability to refinance Westar could potentially face a liquidity crisis."[144]

B. The FERC's Decision

Section 204 of the FPA requires utilities to obtain permission from the FERC before issuing or assuming any securities.[145] Furthermore, before the FERC will approve the request, a utility must establish a lawful purpose and some necessity for the issuance.[146] Although the FERC concluded that Westar met these statutory requirements,[147] the FERC conditioned Westar's request on a few additional stipulations.[148] First, the new debt must only be used to retire outstanding indebtedness, and second, quarterly status reports of its corporate condition must be filed with the FERC.[149]

The FERC then established new restrictions, explaining that it would "impose four additional restrictions and it is the Commission's intention that

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the face of opposition by the KCC and the restrictions imposed by the Investment Company Act of 1940. *Id.*

141. *Id.*

142. *Westar Energy, Inc.*, 102 F.E.R.C. at 61510. Westar was required to provide monthly reports on Westar's debt situation; reduce secured utility debt by $100 million per year; gain the KCC's approval before Westar issued any new debt; separate utility subsidiaries from non-utility subsidiaries; and minimize unfavored accounting problems among Westar's affiliates. *Id.*

143. *Id.* at 61510–11.

144. *Id.* at 61511.

145. 16 U.S.C. § 824c(a) (2000).

146. *Id.*

147. *Westar Energy, Inc.*, 102 F.E.R.C. at 61511 (explaining that "the proposed issuance of long-term, unsecured debt is for a lawful object within Westar's corporate purposes and is necessary, appropriate and consistent with Westar's performance as a public utility").

148. *Id.* at 61512.

149. *Id.* FERC imposed one additional condition, stating that "Westar must file a Report of Securities Issued within 30 days after the sale or placement of the long-term, unsecured debt, as stated in the Commission's regulations." *Id.*

these restrictions will be applied to all future public utility issuances of secured and unsecured debt authorized by this Commission."[150] These four restrictions, outlined below, proved to be the most controversial, and have sparked concerns about the FERC's authority in this area.[151]

> First, public utilities seeking authorization to issue debt that is secured (i.e., backed) by utility assets must use the proceeds of the debt for utility purposes only. Second, with respect to such utility asset-secured debt issuances, if any utility assets that secure such debt issuances are divested or "spun off," the debt must "follow" the asset and be divested or "spun off" as well.
>
> Third, if assets financed with unsecured debt are divested or "spun off," the associated unsecured debt must follow those assets. Specifically, if any of the proceeds from unsecured debt are used for non-utility purposes, the debt likewise must "follow" the non-utility assets and if the non-utility assets are divested or "spun off" then a proportionate share of debt must "follow" the associated non-utility assets by being divested or "spun off" as well. Last, with respect to unsecured debt used for utility purposes, if utility assets financed by unsecured debt are divested or "spun off" to another entity, then a proportionate share of the debt also must be divested or "spun off".[152]

The FERC noted that because of these additional requirements, future public utilities will be prevented from borrowing to finance non-utility businesses, and will thus act more in the public's best interests.[153] And with that simple edict, the FERC added requirements that no other public utility before Westar had been forced to comply with. Although the FPA allowed the FERC to condition approval of a debt issuance on a showing of lawful purpose and necessity, there was no authority cited for the FERC's additional four requirements.[154] Because of this absence of authority, current concerns have driven cries of over-regulation and apprehension over what other areas of management the FERC will soon attempt to control.

Since the *Westar Order*, the FERC has wavered on the new restrictions that were to apply "to all future public utility issuances of secured and unsecured debt . . . ."[155] Within a year of the *Westar Order*, Kandiyohi Electric Cooperative (Kandiyohi), a Minnesota company, submitted an application under section 204 of the FPA[156] and part 34 of the Federal Energy

150. *Id.* (emphasis added).

151. *See* Salamone et al., *supra* note 41, at 30.

152. *Westar Energy, Inc.*, 102 F.E.R.C. at 61512.

153. *Id.*

154. *See id.*; 16 U.S.C. § 824c(a) (2000); *see also* Application of Kandiyohi Power Cooperative for Authority to Issue Securities at 12, 106 F.E.R.C. 61010 (2004) (No. ES04-6-000) [hereinafter Application].

155. *Westar Energy, Inc.*, 102 F.E.R.C. at 61512.

156. 16 U.S.C. § 824c.

Regulatory Commission's Regulations[157] for authorization to issue securities.[158] Because it would use such debt to finance both its regulated and unregulated activities, Kandiyohi sought exemption from the four criteria established by the FERC in the *Westar Order*.[159] Specifically, Kandiyohi sought exemptions from the criteria set forth in the *Westar Order* for both member-owned cooperatives in general, and for itself in particular.[160]

Kandiyohi explained that the commission in *Westar* was concerned over Westar's credit rating and the shaky financial condition of the utility.[161] Furthermore, Kandiyohi noted the following:

> The *Westar* restrictions appear to be designed to prevent investor-owned utilities' (IOUs) stakeholders and management, whose interests are or may be different than the interests of utility customers, from taking actions which may ultimately jeopardize the utility's ability to perform its utility function and may adversely affect its rate payers.[162]

However, Kandiyohi argued that cooperatives are not susceptible to similar conflicts between owners and customers because cooperatives are owned by their customers (ratepayers).[163] Consequently, Kandiyohi argued that the *Westar* restrictions were not justified, even though it qualified as a public utility company.[164]

Kandiyohi then argued that the *Westar* restrictions were beyond the scope of the FERC.[165] "[S]ection 204 of the FPA does not expressly prohibit public utilities from issuing securities to finance non-utility activities."[166] Kandiyohi explained that the FERC instituted the restrictions in *Westar* to prevent utilities

157. 18 C.F.R. §§ 34.1–34.10 (2003).

158. Application, *supra* note 154, at 1.

159. *Id.* at 8–9.

160. *Id.*

161. *Id.* at 9. Kandiyohi elaborated on the commission's decision in *Westar*, stating:

> These policy concerns arose in large part because the financial condition of IOUs, such as Westar, had deteriorated in large part due to their non-utility business activities. With regard to Westar, the Commission found that since 1995 Westar had issued substantial amounts of new debt and used the proceeds to finance non-utility business ventures and to cover operating losses incurred by non-utility business. These activities resulted in the following adverse consequences: the credit rating for Westar securities was reduced to "junk status", Westar debt is more costly and more difficult to obtain on economically favorable terms, Westar's ratepayers are at risk for paying the increased cost of debt if Westar cannot generate enough cash flow from utility operations to cover the increased debt costs; and Westar will be left with a disproportionate amount of debt if it "spins off" some or all of its non-utility businesses.

Id. at 9 n.10.

162. *Id.* at 9–10.

163. Application, *supra* note 154, at 10.

164. *Id.*

165. *Id.* at 12.

166. *Id.*

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

from impairing their ability to function as regulated public utilities.[167] In this instance, however, Kandiyohi argued that its use of utility asset-secured debt will not inhibit its ability to act as a utility, but will actually benefit the utility by funding its affiliated propane business.[168] In essence, this was the exact same argument Westar made one year earlier in its efforts to fund its affiliate "Protection One."[169]

The FERC ultimately agreed with Kandiyohi and issued an order authorizing the issuance of the securities, exempting Kandiyohi itself from the *Westar* criteria, but denying the request to exempt all member-owned cooperatives.[170] The FERC stated that "the Westar restrictions are not needed to protect Kandiyohi's utility customers, and we will not impose them in this instance."[171]

Several months later, Midwest Energy, Inc. (Midwest), a Kansas utility company, filed a request pursuant to section 204 of the FPA to issue securities, and asked for the same exemption from the *Westar* criteria that Kandiyohi had received.[172] Midwest argued that it should also be exempted from the FERC's requirements due to its ownership composition and the benefits that Midwest would derive from the financing.[173] The FERC subsequently approved Midwest's application for the requested exemption and cited the *Kandiyohi Order* without providing additional justification.[174]

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167. *Id.*

168. Application, *supra* note 154, at 12.

> Adequate financial support of its propane business allows Kandiyohi to diversify its interests protecting the financial security of the utility and its owner-customers. Further, ensuring access to affordable propane supplies in rural areas served by Kandiyohi may encourage residents and current member-owners of the cooperative to remain in Kandiyohi's electric service area.

Id. *See generally* Westar Energy, Inc., 102 F.E.R.C. 61186 (2003), 2003 WL 732901.

169. Kandiyohi was basically conveying the sentiment of the Invasion of Management rationale: absent a specific grant of statutory authority, the commission should not be permitted to dictate *how* a utility provides its services to the public.

170. Kandiyohi Power Cooperative, 106 F.E.R.C. 61010, 61024 (2004), 2004 WL 45465.

171. *Id.*

172. Application of Midwest Energy, Inc. for Authority to Issue Long-Term and Short-Term Debt at 3, No. ES04-17-000 (F.E.R.C. Mar. 26, 2004). Midwest was going to use the utility asset-secured debt to fund one of its affiliates, Midwest United Energy (MUE). *Id.* at 10. "MUE is a natural gas marketer that provides Midwest Energy's commercial and industrial customers with the option of accessing competitively-priced supplies of natural gas. In addition, all profits earned by MUE are for the benefit of all of Midwest Energy's customer-owners." *Id.*

173. *Id.* at 10.

174. Letter from Michael C. McLaughlin, Director, Division of Tariffs and Market Development, Federal Energy Regulatory Comission, to William N. Dowling, Vice President, Energy Management & Supply, Midwest Energy, Inc. (May 5, 2004), *available at* http://elibrary.ferc.gov/idmws/nvcommon/NVViewer.asp?Doc=10148472:0.

Thus, while the FERC originally intended that its new restrictions apply to all future public issuances of debt, it has since relaxed its requirements. The restrictions imposed on Westar stemmed from abuses at Westar and other IOUs that used regulated asset-secured debt to fund unregulated businesses to the advantage of the stockholders.[175] The FERC could have simply denied Westar's request in the first place instead of imposing new requirements on all utilities. Since the *Westar* decision, the FERC has refused to grant a broad/generic exemption to the *Westar* requirements to a group, but they have granted exemptions to individual entities when good cause was shown. The fact that the FERC has issued specific exceptions to the *Westar* order immediately after developing the new requirements may indicate that the FERC did not envision the scope of the order it was handing down. Thus, had the Invasion of Management defense been properly applied in the original *Westar* opinion, the FERC could have avoided the numerous utilities that have and will request exemptions to the *Westar* requirements. Moreover, the FERC will certainly face additional scrutiny from the large number of utilities that currently diversify into unregulated affiliates.

IV. IMPLICATIONS OF PUBLIC UTILITY DIVERSIFICATION

Public utilities rarely diversified prior to the mid 1970s, during which time public utilities were experiencing increasing profits due to a slow rise in costs.[176] However, after this period, regulated utilities began to see their financial positions deteriorate, spurring diversification into unregulated areas of business.[177] This allowed utilities to operate a portion of their business free from regulation imposed by commissions.[178]

By preventing public utilities from financing non-utility businesses with debt secured by utility assets, the FERC effectively limited the ability of a utility to obtain favorable financing for non-utility investments. Although some commentators have called for a statutory response to diversification into non-utility businesses,[179] the FERC chose to formulate a response based on a

175. Unregulated investments are generally intended solely to benefit the stockholders, and recent abuses have underscored this fact. Customers, on the other hand, often times do not benefit from this funding.

176. Fickinger, *supra* note 15, at 91.

177. *Id.* "Increased costs are attributable to inflation, high interest rates, stricter environmental controls, and other regulatory requirements." *Id.* at 91 n.26 (citing CABOT CONSULTING GROUP, DIVERSIFICATION IN THE UTILITY INDUSTRY 2–3 (1982)). Furthermore, "[a]s inflation has continually eroded interest coverage ratios for utilities since the 1960's, bond rating agencies have responded by downgrading utility bond ratings and other security ratings. This trend began in earnest in 1972. Accordingly, in the electric utility industry, stocks have sold below book value since 1973." *Id.* at 91 n.28.

178. *Id.* at 91–92.

179. *See, e.g.*, *id.* at 116.

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

broad provision in the FPA, absent specific statutory support.[180] Moreover, commissions do have limits beyond those specifically outlined in statute, and the Invasion of Management defense attempts to preserve public utility autonomy by upholding these limits. "[A] comprehensive grant of public service commission jurisdiction extending over the public utility holding company's non-utility operations must consider the limited levels of funding, manpower, and expertise available to commissions for this task."[181] If these resources are not available to commissions, there would be no interests served by extending a commission's jurisdiction.[182] Thus, when the FERC extended its jurisdiction to include Westar's non-utility businesses, it greatly decreased the chance that any public utility will divest in unregulated affiliates in the future. This is a major blow when one considers the competitive advantages sustained by larger diversified companies.[183]

Several states have facilitated public utilities in their efforts to diversify. In Maryland, for example, the Maryland Public Service Commission rejected a proposal that would require utilities to obtain approval prior to any diversification initiatives, including diversification into unregulated

180. *See* Westar Energy, Inc., 102 F.E.R.C. 61186, 61512–13 (2003), 2003 WL 732901. Section 204 of the FPA requires utilities to obtain permission from FERC before issuing or assuming any securities. 16 U.S.C. § 824c(a) (2000). Furthermore, before FERC will approve the request, there must be a showing of a lawful purpose and that there is some necessity for the issuance. *Id.* Subsection (b) of this act gives the commission broad power to supplement these orders:

> The Commission, after opportunity for hearing, may grant any application under this section in whole or in part, and with such modifications and upon such terms and conditions as it may find necessary or appropriate, and may from time to time, after opportunity for hearing and for good cause shown, make such supplemental orders in the premises as it may find necessary or appropriate, and may by any such supplemental order modify the provisions of any previous order as to the particular purposes, uses, and extent to which, or the conditions under which, any security so theretofore authorized or the proceeds thereof may be applied, subject always to the requirements of subsection (a) of this section.

Id. § 824c(b); *see* Application, *supra* note 154, at 12 (stating that "section 204 of the FPA does not expressly prohibit public utilities from issuing securities to finance non-utility activities").

181. Fickinger, *supra* note 15, at 116–17. The Commission is composed of five commissioners who are appointed by the President with the advice and consent of the Senate. 16 U.S.C. § 792 (2000). This group is in turn given the power "to appoint, prescribe the duties, and fix the salaries of, a secretary, a chief engineer, a general counsel, a solicitor, and a chief accountant; and . . . such other officers and employees as are necessary in the execution of its functions . . . ." *Id.* § 793.

182. Fickinger, *supra* note 15, at 117.

183. *See* Frank J. Hanley & A. Gerald Harris, *Does Diversification Increase the Cost of Equity Capital?*, 128 PUB. UTIL. FORT., July 15, 1991, at 26, 26 (explaining that diversification decreases the total risk and subsequently the cost of equity to utilities); Michael V. Russo et al., *Adding On: How to Make Diversification Work*, 131 PUB. UTIL. FORT., Feb. 15, 1993, at 21, 25 (describing the factors associated with and the benefits derived from successful diversification).

subsidiaries.[184] The commission opined that "the state's public service law only granted authority over rates and public utility services offered by a regulated company. Preapproval of diversification activities was, thus, not required to assure just and reasonable rates and adequate provision of regulated services."[185] Consequently, the FERC's new restrictions could have major implications in striking the balance between commissions and public utilities that diversify into unregulated businesses. While states may afford greater freedom to the portion of public utility business that they govern, it is clear that the FERC will restrict some portions that they control.

It is also important to note that the FERC's concerns arose primarily from Westar's "shaky" financial condition. Thus, one must question why the FERC sought to impose its regulations on *all* future utilities. Prior case law would indicate that the new restrictions imposed on all future public utility companies were unnecessary. Opponents of diversification into non-utility businesses may argue that the utility customer should not be required to fund diversification investments that disproportionately benefit the shareholders over the customers. These opponents, however, should draw on the precedent provided in *Pacific Power & Light Co. v. Public Service Commission*.[186] There, the court found that consumers cannot bear the risk of a faulty project unless the company obtains approval from the commission prior to undertaking the project.[187] Thus, had Westar been attempting to pass on the costs of a failed project to its consumers, the commission could have justifiably stepped in.[188] Westar, however, was only engaged in a debt issuance that *could have* negative implications in the future, but currently only constituted a decision of management. If Westar's affiliate, Protection One, would someday prove unprofitable, Westar would have to bear the cost of the failure instead of consumers.

184. Phillip S. Cross, *MD. Rejects Restrictions on Diversification*, 133 PUB. UTIL. FORT. Nov. 1, 1995, at 45, 45. Baltimore Gas & Electric Company (BG&E) entered into a new business venture and began marketing merchandise and services in the area of kitchen remodeling. *Id.* Ratepayers argued that BG&E was subsidizing this program from rates obtained through their regulated electric and gas business. *Id.*

185. *Id.*

186. 677 P.2d 799 (Wyo. 1984).

187. *Id.* at 808–09. The utility company could not levy the cost of a failed nuclear power construction project against ratepayers. *Id.* at 806.

188. The Supreme Court of Wyoming has explained that a commission "is empowered to control the effect that new energy projects will have on rates—but only after the utility management has assessed the merits and drawbacks of the proposal and reached a final decision based on sound business judgment . . . ." *Id.* at 810.

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

V. THE FUTURE OF PUBLIC UTILITY REGULATION

The FERC recently promised to pursue other actions to prevent events similar to the Enron collapse and the California energy crisis.[189] Specifically, FERC Chairman Pat Wood, III explained that "(1) FERC will seek to ensure 'the right rules' are in place to encourage strong competition in energy markets; and (2) FERC will make efforts to monitor those markets more vigilantly."[190] The *Westar* conditions that will be imposed on all future debt issuances and the reporting requirements for all public utilities are examples of these initiatives at work.[191] All future initiatives, however, should be analyzed under the Invasion of Management rationale.

Thus, in order to come full circle, the *Westar* decision must be reconciled with the Invasion of Management rationale. Courts regularly hold commissions' actions "illegal," but fail to provide a useable test for future courts to apply with some form of uniformity.[192] If a test or standard is to be established, however, it "must be deduced from specific decision rather than from wandering opinion."[193] Consequently, one must piece together the rulings discussed in this Comment to understand the impact the Invasion of Management defense should have had on the *Westar* decision.

As the cases outlined in this Comment have indicated, most statutes, on their face, only grant commissions the power to regulate public utilities when a utility's actions could impact rates.[194] However, general grants often accompany this power, and must be limited by the Invasion of Management defense. A strict method of statutory interpretation[195] would provide public utilities with the independence that management is entitled to have, and it would also establish a test that courts could uniformly apply in interpreting general statutory grants. Although there are gray areas in general grants of power, courts should err on the side of management and allow the capitalist

189. *See* Salamone et al., *supra* note 41, at 30.

190. *Id.*

191. *Id.*

192. *Management Invaded*, *supra* note 23, at 118.

193. *Id.*

194. *See, e.g.*, 16 U.S.C. § 824d (2000); KAN. STAT. ANN. § 66-101b (2002); MO. REV. STAT. § 393.140(5) (2004).

195. According to *Black's Law Dictionary*:

> Strict construction of a statute is that which refuses to expand the law by implications or equitable considerations, but confines its operation to cases which are clearly within the letter of the statute, as well as within its spirit or reason, not so as to defeat the manifest purpose of the Legislature, but so as to resolve all reasonable doubts against the applicability of the statute to the particular case.
>
> Strict interpretation is an equivocal expression, for it means either literal or narrow. When a provision is ambiguous, one of its meanings may be wider than the other, and the strict (i.e., narrow) sense is not necessarily the strict (i.e., literal) sense.

BLACK'S LAW DICTIONARY 333 (8th ed. 2004) (citations omitted).

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

society that we operate in to take care of the rest. It is clear that when states provide statutory grants of power to commissions, "the generally worded grants of power clearly refer to those services and facilities in the area of *direct contact* between the utility and the consumer."[196] In addition, cases have shown that "[c]ommission orders are uniformly upheld when the managerial decision 'invaded' is clearly within the area of direct consumer-utility contact."[197]

Westar's proposed bond refinancing was well within management's prerogative, and arguably outside the area of direct contact between the utility and the consumer. Furthermore, even if financing an unregulated affiliate does involve direct contact between the utility and the consumer, commissions are not permitted to regulate *how* a utility provides services.[198]

Had the court analyzed the *Westar* case under the Invasion of Management framework, the FERC's new requirements would almost certainly have been prohibited, and problems in *Kandiyohi* and *Midwest* would have been avoided. As such, the Invasion of Management defense would have provided a clear test for the FERC to adhere to in issuing its order. Less than ten miles away from Westar's headquarters, a Kansas court explained the commissions' bounds in the area of debt financing many years prior to the *Westar Order*, stating:

> It must be kept in mind, of course, that the regulatory commission does not have the actual authority to *revise* a utility's capital structure, per se, or to order the utility to change it into a different setup. That is a prerogative of management which cannot be superseded by the substitution of regulatory opinion—that is to say, how much debt should be incurred or common stock issued.[199]

Investors in public utilities must continue to receive protection from overzealous commissions. These investors have a right to not only manage their property (a right indivisible from ownership), but also to earn a fair return on their investment.[200] Moreover, numerous policy considerations exist for limiting utility regulation.[201]

First, the physical composition of commissions restricts their ability to competently enter into the management of a public utility.[202] Commissions are limited in personnel, time, and funding, and often lack a background of

196. *Management Invaded*, *supra* note 23, at 118.

197. *Id.* at 119.

198. Intuitively, financing a business deals with *how* a utility provides services to its customers.

199. Sekan Elec. Co-op. Ass'n. v. State Corp. Comm'n, 609 P.2d 188, 191 (Kan. Ct. App. 1980) (quoting E. NICHOLS & F. WELCH, RULING PRINCIPLES OF UTILITY REGULATION, RATE OF RETURN SUPPLEMENT A 157 (1964)).

200. *Management Invaded*, *supra* note 23, at 125–26.

201. *Id.* at 126.

202. *Id.*

practical experience that would permit knowledgeable management of a utility.[203] Commission's decisions are necessarily based on "vicarious knowledge" composed of statistics and theories, rather than internal knowledge derived from long-term contact with utility operations.[204] Furthermore, commissions frequently come under heavy pressure from consumer groups and civic groups lobbying for lower rates and extra services.[205] Commissions often forget that their duty is to the public as a whole and not solely to the special interest group that complains the loudest.[206]

Finally, and most importantly, continual regulation of public utilities can do nothing but weaken privately owned utilities.[207] "If effective private management of utilities is paralyzed by continual forays of regulation, in the long run the public could be hurt most seriously by a continuing decrease in efficiency."[208] Intuitively, one can easily understand that a business that continually becomes less profitable will also be less attractive to investors. It necessarily follows that incentives to invest will dwindle, along with compensation of upper-echelon management, middle management, and all other employees. As a result, public utilities will become less efficient and poorly managed, eventually resulting in rate spikes to reverse the cycle.

Consequently, the Invasion of Management defense is of practical application to any commission regulation that is not impressed with direct consumer–utility contact. When applied correctly, the defense prevents commissions from continual forays into the management of a utility, forays that could ultimately prove detrimental to the utility and the public.[209] Moreover, the opinions in this area either expressly, or based on their rationale, indicate that the Invasion of Management defense is not moribund. In the wake of Enron, and other similar situations, applying the Invasion of Management defense is a difficult task, but one that must be taken to preserve the model of public utilities that the United States currently operates under. The defense supplies a rationale that courts can apply much easier than wading through wandering opinions as many recent courts have been inclined to undertake. Regardless of the disasters associated with deregulation in

203. *Id.*

204. *Id.*

205. *Management Invaded*, *supra* note 23, at 126. These special interest groups commonly "ignore the rights of owners to a fair return and unfettered management of their property within the proper limits." *Id.*

206. *Id.* at 127.

207. *Id.*

208. *Id.*

209. As previously discussed in this Comment, if management is over-regulated, public utility companies could eventually become unattractive to investors, creating financial difficulties for the utility companies and ultimately increasing prices offered to consumers. *See supra* text accompanying notes 200–08.

SAINT LOUIS UNIVERSITY SCHOOL OF LAW

California and the Enron crisis, "deregulation has brought consumers in certain states lower prices, greater choice, greater efficiency in generation, transmission, and distribution, preservation of reliable service, and environmental preservation."[210]

So, after more than fifty years, one question remains: What areas of management were truly intended to remain with management? As the cases indicate, the test for when management has been invaded remains unclear to this day. However, it is important to recognize that commissions cannot act beyond the intent of the general grants provided by state and federal legislation. To do so would not only undermine the management of the public utility, but could also erode the current system by eliminating any profitability incident to private ownership. It is important to again note that "utility regulation . . . depends on[] private ownership and management. Nothing so far discovered in the Constitution prohibits public ownership of all utilities. If the state legislatures had wished to own and manage utilities they could have done so."[211] As a result, courts must strike a balance between over-regulation and regulation necessary to protect the public. To do so, the rationale intrinsic to the Invasion of Management defense must be considered.

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210. Waller, *supra* note 16, at 755.

211. *Management Invaded*, *supra* note 23, at 126.

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