

SC91109

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IN THE SUPREME COURT OF MISSOURI

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ARBOR INVESTMENT CO., LLC, et al.,

Appellants,

vs.

THE CITY OF HERMANN,

Respondent.

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**BRIEF OF THE MISSOURI PUBLIC UTILITY ALLIANCE, THE MISSOURI  
JOINT MUNICIPAL ELECTRIC UTILITY COMMISSION, AND THE  
MUNICIPAL GAS COMMISSION OF MISSOURI, COLLECTIVELY  
REFERRED TO AS THE MISSOURI PUBLIC UTILITY ALLIANCE (MPUA),  
AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT THE CITY OF HERMANN**

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Howard C. Wright, Jr.  
Mo. Bar # 19391  
2113 S. Rosebrier Place  
Springfield, Missouri 65804  
Telephone (417) 883-6705  
Facsimile (417) 864-1551  
[howardcwright@mchsi.com](mailto:howardcwright@mchsi.com)

Douglas L. Healy, Esq.  
MO Bar 51630  
Healy & Healy,  
Attorneys at Law, LLC  
939 Boonville, Suite A  
Springfield, MO 65802  
Ph: (417) 864-8800  
Fx: (417) 869-6811

Attorneys for Amici Curiae

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**INTEREST OF THE MISSOURI PUBLIC UTILITY ALLIANCE (MPUA), THE  
MISSOURI JOINT MUNICIPAL ELECTRIC UTILITY COMMISSION  
(MJMEUC), AND THE MUNICIPAL GAS COMMISSION OF MISSOURI  
(MGCM), COLLECTIVELY REFERRED TO AS THE MISSOURI PUBLIC  
UTILITY ALLIANCE (MPUA)**

All parties to this appeal have consented to the filing of this brief by *Amici Curiae*, the Missouri Public Utility Alliance (MPUA), the Missouri Joint Municipal Electric Utility Commission (MJMEUC), and the Municipal Gas Commission of Missouri (MGCM), collectively referred to as the Missouri Public Utility Alliance (MPUA), as required by Missouri Court Rule 84.05(f)(2).

The Missouri Public Utility Alliance (the “MPUA”), is an association of political subdivisions that represent 108 electric, natural gas, water, wastewater and broadband utilities owned by political subdivisions that work together through cooperative action as members of the MPUA for the benefit of their respective political subdivision. Any political subdivision that owns a utility may belong to the MPUA. The MPUA includes two closely aligned yet distinct operating organizations that have joined in the *amici curiae* brief of the MPUA because of concern with respect to the potential impact of a decision in this case on its members. The Missouri Joint Municipal Electric Utility Commission (the “MJMEUC”) has a membership of 58 electric systems owned by political subdivisions that supply electricity to about 347,000 retail customers. The Municipal Gas Commission of Missouri (the “MGCM”) has 18 political subdivision members who operate gas utilities for about 7,300 customers in Missouri. The members

of the MGCM cooperate in the bulk purchase of gas for resale to member cities.

Collectively, the MPUA, the MJMEUC and the MGCM have filed this brief as *amici curiae* and are referred to in this brief as MPUA since all are members of the MPUA.

The Appellants contend, in their sole “Point Relied On,” that the City of Hermann (referred to in this brief at times as either the “City” or “Hermann”) was not entitled to Summary Judgment because the undisputed facts show that the City sets utility charges at a level designed to increase the City’s general revenue to subsidize general government expenditures rather than to compensate for the provision of utility services in violation of article X, section 22 of the Missouri Constitution.

The interest of the members of MPUA could be affected by the outcome of this case because some of its members have not required a majority vote of their electorate to transfer funds from their utility operations to the general fund of the political subdivision to compensate for other city services such as police, fire, other emergency services, and services related to the provision of city rights-of-ways and easements used by the utility, as well as other services provided by the political subdivision.

In addition, some members of the MPUA may provide free or subsidized services such as street lighting, traffic signal lighting, heat, water pumping, use of employees and other resources or services, and lighting to city-owned buildings and grounds from utility funds. Transfers of funds from the utility to the general fund and the free or subsidized services described above have a long-standing history, established well before November 4, 1980, the date when voters approved the Hancock Amendment. Utility services may be provided in combination with other city services like billing, communications and in

particular emergency communication services that may be operated from a common facility in a situation where it is almost impossible to keep cost accounting records as suggested by the Appellants. Equipment may be maintained and serviced at one facility in order to achieve economies of scale. Even the most basic service by the public utility such as providing potable water, involves two separate and distinct components. One component is the need for adequate water pressure for firefighting purposes, which is significantly higher than the pressure needed to deliver potable water to customers. How do you allocate the costs of these services? One is a firefighting component, a separate government function that is interrelated to the delivery of potable water to utility customers. Some members of the MPUA provide an array of utility services (Hermann provides water, gas, wastewater, electric and solid waste) while others may provide only one service. Many of the estimated 700 political subdivisions in this state are not members of the MPUA, although they may also provide utility services and in particular public wastewater treatment services.

The transfer of funds from the utility arm of the political subdivision to the general fund generally described above is based on a number of factors including payments approximating what the political subdivision might charge or require of a private utility in a franchise as noted in Pace v. City of Hannibal, 680 S. W. 2d 944 (Mo. banc 1984). Many of the fund transfers from the utility accounts to the general fund by members of the MPUA may have been made pursuant to a variety of practices ranging from a long-standing informal custom described in Pace v. City of Hannibal, *Id.* to a formal procedure described in U. S. v. City of Columbia, Mo., 914 F.2d 151 (8<sup>th</sup> Cir. 1990). The transfer of

revenue from the utility to the general fund of the city has been described in a number of ways such as a payment in lieu of taxes, a payment in lieu of a franchise fee, a profit, a gross receipts tax or just a transfer of funds from the utility to the general fund of the political subdivision, which may be referred to at times in this brief as a “PILOT.”

Whatever the transfer is called the substance of the transaction remains the same; a transfer of funds or free or subsidized services from the utility arm of the city to the general fund of the city used for other general government purposes. It is also useful to note at the outset that while a board of public utilities may operate the utility as a board, there is one legal entity, the political subdivision. Glidewell v. Hughey 314 S.W.2d 749, 752 (Mo.1958).

While there are many reasons for these transfers which will be discussed later in more detail, it is clear that a public utility, like a private utility, makes unique and extraordinary use of city easements and rights-of-ways and emergency city services like police, fire, ambulance or hazmat services as well as other city services to an extent not made by other persons; that many services are comingled; and that real and personal property of a political subdivision is not subject to taxation under article X, section 6 of the Missouri Constitution, nor is a political subdivision subject to sales or use taxes under article III, section 39 (10) of the Constitution of the State of Missouri. As a consequence, the operation of a public utility without reimbursement for lost revenues to the general fund of the political subdivision means that the services described above would have to be provided free to the public utility without any compensation. A decrease in the funds

to support these services would cause a significant reduction in revenues that will immediately have an adverse affect on the finances of members of the MPUA.

The MPUA also fully supports and adopts the argument set forth by the City of Hermann and the Missouri Municipal League.

## ARGUMENT

### **A. A transfer of utility funds to the general fund is neither a tax nor a fee.**

The Appellants argue that the transfer of utility revenues to the general fund of Hermann if used for other non-utility purposes is a tax. The MPUA will first address the issue of the PILOT approved by Hermann prior to November 4, 1980. The MPUA starts its analysis with Pace v. City of Hannibal, *supra*, the only Missouri appellate court case to consider whether or not a transfer of funds from utility revenues to the general fund of a city for other city purposes violated article X, section 22 of the Constitution of the State of Missouri because it had not been approved by the voters of the political subdivision.

In 1984 this court held in Pace v. City Hannibal, that:

Inasmuch as the payments do not fall within the compass of “tax, license or fees,” there is no ground for applying the “rollback” provisions triggered by a broadening of the base for a “tax, license, or fees.” Here too the language of the amendment simply does not fit the facts before us. Lc 80 S. W. 2d 948

The court in Pace explained at 948 that there is no similarity to the user fees considered in Roberts v. McNary, 636 S. W. 2d 332 (Mo. banc 1982) because the payment in lieu of a franchise fee to the city general fund in Pace was not charged against the users. The court in Pace further notes at 948, that the existing percentage factor is applied to increases in utility fees; therefore the payment does not amount to the imposition of a “tax, license or fee” in the sense of article X section 22 (a) of the Missouri Constitution. Elaborating further, the court at 948, states that the purpose of a payment in lieu of a franchise fee is to place public utilities on the same basis as investor-

owned utilities that require a franchise to operate, noting that the payment of the franchise fee is to compensate, in part, the political subdivision for the use of public property such as streets for the location, maintenance, and repair of the utilities distribution facilities by requiring the utility to repay the political subdivision for the inconvenience and the expense of attending the use of public property. In addition, the court in Pace concludes at 948, were it not for the payment in lieu of a franchise fee, it would be appropriate for the city to charge the public utility for the fair value of the use of public property, including provision for maintenance and repair on account of wear, tear and damage attributable to the public utility.<sup>1</sup>

In many respects, this case is strikingly similar to Pace v. City of Hannibal, supra (not mentioned in Appellants Substitute Brief). First, the ordinance authorizing the gross receipts tax by Hermann and the ordinance authorizing a payment in lieu of franchise fees in Pace were both enacted before November 4, 1980, the date on which the voters approved the Hancock Amendment (article X, section 22 of the Constitution of the State of Missouri). The Hermann ordinance covered water, sewer and electrical utilities. LF 96-99. Second, the underlying transaction in this case and in Pace was fundamentally the same - a transfer of funds from utility revenues to the city general fund to help pay for

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<sup>1</sup> It is well established that repeated utility cuts on city streets will adversely affect the life expectancy of the pavement. See ICPI Tech Spec Number 7 -- 1996 -- Revised August 2001. This is just one example of the expenses imposed by the municipal utility against the municipality.

other city services. As noted in the Statement of Interest by the MPUA, the payment of the PILOT is in exchange for services provided by the political subdivision like police and fire protection as well as numerous other city services including the use and maintenance of rights-of-ways and easements. Without the payment of the PILOT, the cost of these services would fall on the taxpayers of the political subdivision. Third, the amount of funds transferred in Pace and in this case - the total revenues resulting from the Hermann PILOT - increase whenever the city raises its charges for utility services because it is based on a percentage of utility revenues, not because the pre-Hancock gross receipts percentage was increased.

What is so striking about this case and Pace is not only their similarities, but also the straightforward legal principles which could resolve many of the issues in this case. First, since the gross receipts tax was adopted by Hermann prior to November 4, 1980, the effective date of the Hancock Amendment, it is clear that additional revenues from the application of the gross receipts tax to increases in utility charges are not subject to article X, section 22 of the Missouri Constitution since the percentage remains the same. Pace v. City of Hannibal, at 948. This conclusion is reaffirmed by the court's subsequent holding in Tax Increment Financing Comm'n of Kansas City v. J. E. Dunn Const. Co., Inc., 781 S. W. 2d 70,74-75 (Mo. 1989). As the court stated in Pace at 948, the application of the same percentage to higher utility rates is not an increase in a tax or a fee, and does not amount to the imposition of a tax or a fee; consequently, additional revenues from Hermann's gross receipts tax do not violate article X, section 22 of the Missouri Constitution. Article X, section 22 of the Missouri Constitution does not limit

revenues; it is not a spending limit, but a limit on the imposition of new taxes or increases in existing taxes without approval of a majority of the electorate. Zahner v. City of Perryville, 631 S. W. 2d 321, 326 (Mo. Banc 1982).

Even though the court in Pace could have decided the case based on a PILOT that existed prior to November 4, 1980, the effective date of the Hancock Amendment, and that there was no tax levied or imposed by the transfer of funds by Hannibal, the court went out of its way to declare that a payment in lieu of a franchise fee was neither a tax nor a fee. Pace at 948. The revenues from the gas utility and the communications and billing charges were simply an administrative transfer of funds.

The 1984 decision in Pace v. City of Hannibal, supra, was sandwiched between the 1982 decision in Roberts v. McNary, supra, which held that voters must approve “any” increase in taxes, licenses and fees after November 4, 1980, and Keller v. Marion County Ambulance District, 820 S. W. 2d 301 (Mo. banc 1991) which overruled the expansive interpretation given to the words, “tax, license or fee” in Roberts. When the court decided Keller v. Marion County Ambulance District, supra, it recognized what it termed as obvious, that there were some charges made by political subdivisions that did not fit the all-encompassing mold of Roberts.

To the extent that this language constitutes the holding of *Roberts*, it has been overruled by this Court *sub silentio* in several cases. *See Zahner v. City of Perryville*, 813 S.W.2d 855 (Mo. banc 1991); *Tax Increment Financing Comm'n v. J.E. Dunn Construction Co., Inc.*, 781 S.W.2d 70 (Mo. banc 1989);

*Pace v. City of Hannibal*, 680 S.W.2d 944 (Mo. banc 1984); *cf. Oswald v. City of Blue Springs*, 635 S.W.2d 332 (Mo. banc 1982). Lc

There is nothing to suggest that the holding in Pace, as well as the other cases cited directly above, were changed by the courts opinion in Keller, supra.

**B. Cases prior to and since Pace hold that a PILOT is not a tax.**

There is a substantial body of case law prior to and since Pace that gives us a compass to determine if a transfer of utility revenues by a political subdivision to the general fund if used for another purpose is a tax. In another very important case on whether or not a PILOT is a tax, (also not cited by the Appellants) the 8<sup>th</sup> Circuit held in U.S. v. City of Columbia, Mo., 914 F.2d 151 (8th Cir. 1990) that the PILOT authorized by the charter of the City of Columbia, Missouri, was not a tax. The charter of the City of Columbia provided that the utility would pay into the general revenue fund of the city annually an amount substantially equivalent to that sum which would be paid in taxes if the water and electric works were privately owned. The District Court ruled for the United States on the very grounds that Appellants urge this court to adopt; the charge was an “enforced contribution to provide for the support of government.” The 8<sup>th</sup> Circuit in U. S. v. City of Columbia at 154 rejects outright the very test Appellants claim is dispositive (earmarking of revenues for the general fund) and precedes to look at all the facts and circumstances and assess them on the basis of the economic realities concluding that the PILOT was simply the profit component of the sale of a product, **the measure of lost tax revenue**. The lost revenue rationale used in U. S. v. City of Columbia was also used in Pace, although the court in Pace noted in addition at 948 that the city of Hannibal

would be entitled to charge its Board of Utilities for the fair value of the use of public property, including maintenance and repair on account of wear and tear and damage attributable to the utility. Since a public utility pays no city taxes by law (article X, section 6 and article III, section 39(10) of the Constitution of the State of Missouri) and the city provides police, fire, emergency and other city services and allows the use of the city rights-of-ways for public utility purposes, the revenues from the PILOT are compensation for numerous services provided by the political subdivision to its public utility. Without compensation to the political subdivision, the taxpayers will pay for these services, not the utility customers, who are a separate and distinct group that benefit from other city services in the delivery of utilities. Consideration must be given to the difficulties or impossibility of a cost accounting system to allocate the costs of emergency services, joint services and other services where more than one city function benefits like the cost of providing potable water to customers who only need a minimal water pressure while the fire department needs a much higher water pressure to fight fires, which is addressed in detail later in this brief. Implicit in the decisions in Pace and U.S. v. Columbia is the recognition that a PILOT is a reasonable method to compensate the political subdivision for these services which benefit the utility customer. Mandating a requirement that public utilities use cost accounting as suggested by the Appellants and the Attorney General/State Auditor belies the complexity of the matter.

Both Pace and U.S. v. City of Columbia are consistent with long-standing Missouri case law that recognizes a municipal utility may charge a profit and does not have to charge just the cost of the service. St. Louis Brewing Ass'n v. City of St. Louis,

140 Mo. 419, 37 S.W. 525, 528 (1896). Shepherd v. City of Wentzville, 645 S.W.2d 130, 134 (Mo. App. E.D. 1982) stands for the proposition that water rates are not taxes. The rate a governing body of a municipal utility is allowed to charge is not in the nature of taxation, but is in the nature of a toll, like the rental of property. 12 McQuillin Mun. Corp. § 35:59 (3rd ed.). See also: State ex rel. City of Springfield v. Public Service Commission of State of Mo., 812 S.W.2d 827, 831 (Mo. App. 1991) (overruled on separate grounds).

### **C. Sale of utility products and services are consensual.**

At the heart of U. S. v. City of Columbia, *supra*, is the basic concept that acquisition of utility products and services is contractual and consensual in nature. The obligation of the United States did not arise automatically as does a tax liability, but arose from its consensual purchase of electricity, water and related services pursuant to a voluntary contractual relationship with the City of Columbia. U. S. v. City of Columbia, at 156. The very nature of the sale of electricity, gas, water, sewer, and solid waste collection services show at their core that these are sales of products or services. Even the acquisition of utility services from the City of Columbia by the United States government for important public services was held to be consensual in U. S. v. City of Columbia, at 155-156, arising from the contractual nature of the acquisition of utility service despite the right of the city to disconnect utilities for nonpayment. Disconnection of utilities for non-payment is the very same remedy used by Hermann. The court in U. S. v. City of Columbia, at 156 recognized that a PILOT has some of the characteristic of a tax in that it earmarks revenue for the general revenue fund of the City of Columbia but

refused to consider that fact alone to the neglect of many other factors that revealed the PILOT was part of the City's utility rate.

Consider that even though Amtrak was required by Congress to provide service to a city, the requirement to provide service does not make the transaction nonconsensual. The court in National R.R. Passenger Corp. v. City of New York, 882 F.2d 710, 713-716 (C.A. 2 N.Y. 1989) found that this requirement did not change the nature of the payment for facilities from rent to a tax.

The question is when the words "tax and fee" are used together with the word "imposed," how does one construe the meaning of the word "fee"? Is this just a fee or is it a tax disguised as a fee? The words "levied" or "imposed" connote a unilateral act imposed by the sovereign on its citizens. National Cable Television Ass'n, Inc. v. U. S., 415 U.S. 336, 341, 94 S. Ct. 1146, 1149 (U.S. 1974). The use of the verbs "imposed" and "levied" normally apply to taxes and non-consensual fees and require the court to look at the legislative intent. National R.R. Passenger Corp. v. City of New York, 882 F.2d 710, 714 (C.A.2 (N.Y.) 1989)

Of course that is exactly what the court did in Keller v. Marion County Ambulance District, 301. When examining the use of the language "levying" or increasing the current levy of a "tax, license or fees," Keller makes it clear that a "fee" in the context of article X, section 22 must be in the nature of a tax, thereby requiring that there be a levy.

While the court in U. S. v. City of Columbia, supra, did not undertake an analysis of article X, section 22 of the Missouri Constitution, it did review the Columbia PILOT

under law in the context of whether or not it was a fee or a tax in much the same way the court did in Keller. See National Cable Television Ass'n. v. United States, 415 U.S. 336, 340-41, 94 S.Ct. 1146, 1149, 39 L.Ed.2d 370 (1974) (discussing the difference between taxes and fees); National R.R. Passenger Corp., 882 F.2d at 715-16 (discussing the difference between tax and rent obligations); In re Lorber Industries of California, Inc., 675 F.2d 1062, 1066 (9th Cir.1982) (difference between taxes and fees) U.S. v. City of Columbia, Mo., 914 F.2d 151, 156 (C.A.8 (Mo.),1990)

The Appellants and the Attorney General/State Auditor have suggested that public utilities are monopolies and that the consumer does not have a choice, and used such argument as the grounds for a radical departure from current law. The record in this case shows that some consumers do not subscribe to one or more of the utility services of Hermann, nor do all taxpayers of Hermann subscribe to utility services. (LF 91: 1595) In addition, their argument ignores that the consumer has available other choices, and while these choices may not be easy, the difficulty does not change the underlying nature of the transaction. For example, it is possible to heat with wood, and to heat and cool with solar, wind, geothermal, and bio fuels. There are options to utility water service such as wells, cisterns or rainwater, and of course conservation can drastically reduce the need and the costs for most of these services. Businesses and citizens can weigh utility costs when relocating, as well as their utility alternatives. Citizens as voters can elect new council members who share their views, thereby changing the practices of the political subdivision, a right not enjoyed by anyone else when you object to the price of a product

or service. All of this can have a downward pressure on the ability of a city to raise its utility prices.

The argument by the Appellants and the Attorney General/State Auditor that there is no choice is not supported by case law or a factual record, and does not reflect the current options enjoyed by citizens in Missouri.

The above cases support not only the pre-Hancock PILOT established by Hermann, but also any additional charges above the PILOT as well as the communications and collection fee challenged by the Appellants.

#### **D. Proposal to formulate new Hancock test for PILOT's**

The Appellants and the Attorney General/State Auditor propose rejecting the Keller test and replacing it with a formula that compares over time the proportion of utility revenues related to “general revenues” hereinafter referred to as the Proposal. This Proposal is over simplistic, ignores the “real world,” and presumes all municipal utilities operate the same. Utility revenues may increase or they may decrease depending on the economy or other factors, consequentially the political subdivision bears the risk that its PILOT revenues may decrease not just increase. This Proposal assumes that the value of the PILOT is static even though costs increase due to inflation as well as numerous other factors such as the costs to acquire rights-of-ways and easements, environmental issues as well as the costs to construct and maintain city property and to provide police, fire and other city services to the utility. Certainly the fact that the costs to provide legitimate

public services to the utility increase should not cause the PILOT to suddenly become a tax. If rates are increased, how and when do you apply the adjustment to revenues?

Costs incurred by utilities are frequently affected by factors completely beyond their control. Environmental obligations, obligations to serve as a result of community growth and, most significantly, fuel prices and weather, all factor into a utility's costs, and therefore, rates. Prudent utility practice requires utilities to plan and construct expansions and upgrades years, if not decades, in advance of those benefits being useable by their current customer base; water and energy plants cannot be economically incrementally decreased and increased to match existing needs. If these factors, from one rate cycle to another, result in a different proportion of "utility services" compared to the "general revenue" received from the city, the rates are still completely cost-based, and have nothing to do with what might be considered a "tax." While the proportions might increase or decrease depending on the particular rate formula for that rate cycle, there is no basis to assume any intention to benefit the city's "general fund." Further, what is the frame of reference? Does the "general fund" proportion automatically reset to the smallest fraction, whenever that might occur?

There are many other reasons why a city might seemingly increase a revenue share from utilities that have nothing to do with a transfer to the general fund. For example, a city or utility might determine to increase its reserves in consideration of looming utility obligations, such as capital or environmental requirements thought likely to occur in the future. If those requirements were greater than historic requirements, basic good management to accumulate funds beyond current requirements would thus be subject to

refund under the Proposal, significantly damaging the utility's ability to operate. Would a rate increase to cover the new PILOT designed to capture future costs, which is a very real cost to the utility, be subject to refund by a utility that collected the increase through its rates, and thus suffer a shortfall in its operational requirements? Such an action would not only be catastrophic to the utility and its customers who would be required to come up with a large sum of money in a few short billing cycles when the actual costs were incurred (and again, not necessarily the same customers would reap the ultimate benefit of such investment), but would also effectively keep municipal utilities from seeking financing, as such uncertainty would likely deter any prudent investor from investing in bonds or other debt instruments secured by the municipal's utility operations, or even the municipality itself.

For the above reasons, the MPUA believes that the Proposal is not workable or related to prudent utility management, and even more important, there is no case law to support the Proposal since article X, section 22 is not a limit on revenues. In addition, the record in this case is not sufficient to change the law because almost all of the facts are disputed.

### **CONCLUSION**

A PILOT is neither a tax nor a fee. A PILOT is not levied nor imposed; it is part of a utility rate and represents an accounting transfer of funds from the utility fund to the general fund of the political subdivision for lost revenues or for costs incurred by the political subdivision in the use of its rights-of-ways and easements and police, fire as well as other emergency services and other city services. The purchase of utilities by the

customer is the consensual acquisition of a product or a service pursuant to a contract. The five-part test established in Keller provides an adequate basis to analyze utility charges. For these reasons this Court should affirm the Judgment in this case.

If the court feels that the five-part Keller test needs to be reexamined, this is not the appropriate case because there is an inadequate record to sufficiently evaluate the consequences of a change in law that has far reaching implications. A review of the Motion for Summary Judgment filed by the Respondent shows that almost every fact was disputed although there is no dispute that Hermann did transfer funds from its utility accounts to the general fund of the City for other city purposes. A change in law should be based on a full and adequate record, which this case does not provide. In addition the Appellants have a remedy to challenge fees that are unreasonable under existing case law.

For these reasons the MPUA urges this Court to affirm the Judgment.

Respectfully Submitted,

By: \_\_\_\_\_  
Howard C. Wright, Jr,  
MO Bar # 19391  
2113 S. Rosebrier Place  
Springfield, MO 65804  
Telephone (417) 883-6705  
Facsimile (417) 864-1551  
[howardcwright@mchsi.com](mailto:howardcwright@mchsi.com)

Douglas L. Healy, Esq.  
MO Bar 51630  
Healy & Healy, Attorneys at Law, LLC  
939 Boonville, Suite A  
Springfield, MO 65802  
Ph: (417) 864-8800  
Fx: (417) 869-6811

**Attorneys for *Amici Curiae***

## **CERTIFICATE OF COMPLIANCE**

The undersigned hereby certifies that the foregoing brief complies with the requirements of Rule 55.03; and the limitations set forth in Rule 84.06(b) in that it contains 5,611 words and was produced using Microsoft Word 2000 Version; and that the CD accompanying this brief has been scanned for viruses and is certified to be virus free.

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Howard C. Wright, Jr.

## **CERTIFICATE OF SERVICE**

The undersigned hereby certifies that one copy, along with a CD and email was provided to all attorneys of record by depositing same, postage prepaid with the United States Postal Service this 5<sup>th</sup> day of November, 2010, to:

Kenneth Heinz  
Curtis, Heinz, Garrett and O'Keefe, P.C.  
130 S Bemiston Ave., Suite 200  
Clayton, MO 63105

David Politte  
438 West Front Street  
P.O. Box 2114  
Washington, MO 63090

Thomas B. Weaver  
James E. Mello  
Jeffrey T McPherson  
Armstrong, Teasdale LLP  
One Metropolitan Square, Suite 2600  
St. Louis, MO 63102-2740

Daniel Vogel  
Paul Rost  
75 West Lockwood  
Suite One  
St. Louis, MO 63119

Attorney General of Missouri  
Chris Koster  
P.O. Box 899  
Jefferson City, MO 65102

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Howard C. Wright, Jr.