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RECEIVED  
SEP 14 2006  
SOUTH DAKOTA PUBLIC  
UTILITIES COMMISSION

RE: **NORTHWESTERN/BBI**  
Docket GE06-001  
Our file: 0230

Dear Patty:

Enclosed are original and 10 copies of Applicants' Brief on Jurisdiction as called for in the scheduling order. Please file the enclosures.

You will note that the brief is being submitted past its due date. The parties have had difficulty agreeing on a confidentiality agreement and the intervenors have therefore not had an opportunity to review all of the data request responses to staff's data requests. However, staff has received the confidential information.

In order to keep this matter moving and in view of the fact that we believe a conference call will be held in the near future to reformulate the scheduling order, we have elected to file the initial brief at this time. The legal points to be made in the brief do not depend upon the confidential

Patricia Van Gerpen  
September 14, 2006  
Page 2

materials, which simply provide detail and background to the figures relied on the brief.

With a copy of this letter, I am sending copies of the brief to the service list. Thank you very much.

Yours truly,

MAY, ADAM, GERDES & THOMPSON LLP

BY:

A handwritten signature in black ink, appearing to read "Adam Gerdes". The signature is fluid and cursive, with a large initial "A" and a long, sweeping tail.

DAG:mw

Enclosures

cc/enc: Service List  
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SEP 14 2006

SOUTH DAKOTA PUBLIC  
UTILITIES COMMISSION

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE MERGER	)	DOCKET NO. GE06-001
BETWEEN NORTHWESTERN	)	
CORPORATION AND BBI GLACIER	)	
CORP., A SUBSIDIARY OF	)	APPLICANTS' BRIEF
BABCOCK & BROWN	)	ON JURISDICTION
INFRASTRUCTURE LIMITED	)	

NorthWestern Corporation ("NorthWestern") and Babcock & Brown Infrastructure Limited ("BBIL") (together, the "Applicants") file this brief to the Commission on the question of jurisdiction presented by the Petition for Declaratory Ruling and for Transaction Approval if Jurisdiction Found ("Petition"):

SUMMARY OF ARGUMENT

The Petition presents a two-level analysis for the Commission, first, whether the Commission has jurisdiction over the Applicants empowering it to approve or disapprove the transaction and, if jurisdiction is found, whether the Commission will approve the transaction. Thus, the threshold "first" question of jurisdiction must be answered in the affirmative for the Commission to pass on the second question as to the merits of the transaction.

Two statutes bear on the question of jurisdiction. The first, SDCL § 49-34A-35, does not apply because it is nullified by SDCL §

49-34A-38 where, as here, FERC jurisdiction exists. An application for approval from the FERC is pending and into which the State and certain businesses in the state have intervened.

The second statute, SDCL § 49-34A-38.1, gives the Commission jurisdiction to approve or deny the transaction if NorthWestern receives “. . . more than 25 percent of its gross revenue in this state . . . .” For the year ended December 31, 2005, gross regulated revenue in the state was 14.72 percent of the gross regulated revenue of the company; the gross regulated revenue combined with unregulated revenue earned in the state was 20.84 percent; and the gross regulated revenue combined with in-state and out-of-state unregulated revenue was 25.23. Based on the 12 months ended June 30, 2006, the same percentages were 14.82 percent, 19.78 percent and 23.84 percent. The percentage derived from combining total South Dakota regulated revenues with unregulated revenues will continue to fall because NorthWestern’s restructuring plan calls for it to eliminate unregulated gas revenues.

Because the statutory limitation to revenues earned “in this state” is clear and unequivocal, the 25 percent threshold cannot be met. At most the Commission can consider gross regulated revenue

combined with in-state unregulated revenue, yielding percentages of 20.84 at year end 2005, and 19.78 ending in June, 2006. The Commission lacks jurisdiction.

## DISCUSSION

### Questions Presented

Under the Petition, as to jurisdiction, three questions are presented:

1. As used in SDCL § 49-34A-38.1 does the term "gross revenue in this state" include regulated gross revenue or all revenue, both regulated and nonregulated, wherever incurred?
2. If the term includes all revenue in this state both regulated and nonregulated, wherever incurred, does revenue actually generated outside the state of South Dakota but allocated to this state by accounting requirements constitute "gross revenue in this state" for the purpose of the statute?
3. Do the levels of revenue pertinent to any jurisdictional analysis provide the Commission with jurisdiction over the transaction?

1. Better reasoned authority holds that "gross revenue" is a broad standard but that "in this state" is a definitive limiting factor, limited to revenues actually generated in South Dakota.

(A) Gross Revenues

Most courts faced with the term "gross revenue" without limiting language and without a statutory definition, have given it a broad interpretation. In City of Dallas vs. FCC, 118 F3d 393 (5<sup>th</sup> Cir. 1997), the court concluded that "[u]nless expressly limited by the terms of a statute, regulation or contract, gross revenues means all amounts received from operation of a business, without deduction. In so doing however, the court acknowledged that "when a statute uses a technical term, we must assume that Congress intended it to have a meaning ascribed to it by the industry under regulation." Id. at 395 (citing McDermott International, Inc., vs. Wilander, 498 U.S. 337, 342, 111 S.Ct. 807, 810, 112 L.Ed.2d 866 (1991)). In this case we are dealing with the term used in a public utility context.

We have found one case which specifically looked at whether the term "gross income" applied to the unregulated portion of a public utility. Wiseman vs. Arkansas Power & Light Co., 190 Ark. 351, 78 SW2d 818 (1935). The utility was principally involved in

distributing electricity, gas and water, but it also conducted an ice business on the side. The court was asked to determine whether the utility's unregulated ice business revenue could be considered part of the company's "gross income" that was subject to state tax. The court concluded that the unregulated revenue should not be included as part of the gross revenue:

The appellee has a right to employ its capital or use it in any authorized and lawful business, and such part of its capital as may not be employed in any of the regulated utilities, or in matters incident thereto, may produce gross earnings not subject to the tax. Id. at 819.

The line of reasoning employed in the Arkansas Power case makes sense in the context of public utilities. That is, that that portion of a company's capital employed in a separate unregulated business should not be viewed as generating income being derived from the capital employed in a regulated context. As a general principle of ratemaking, utility rates and rates of return are limited to jurisdictional assets, and nonregulated investments are always carefully segregated from utility assets to prevent any impact on utility assets from unregulated operations. See, e.g., SDCL § 49-34A-19.1 (Separate accounts required for nonutility business).

Many cases exist addressing the concept of gross revenue related to companies whose revenue is not regulated. In those cases, as might be expected, unless context or statute indicates otherwise, the term gross revenue is broadly defined.

This line of reasoning was upheld by the Oregon Tax Court dealing with the term "all gross revenue." While the court held that the term appeared to be intended by the Legislature in the broadest sense of those words, it also observed that "the purpose and context of the legislation must guide the court in its interpretation of the terms used." Lane Electric Co-op vs. Department of Revenue, 1987 WL 20276 (Or. Tax), 10 Or. Tax 501, 504. The admonition in this and other cases simply is that the context and history of legislation is relevant to the overall interpretation of its application. On the other hand the Eighth Circuit Court of Appeals in First Trust Co. of St. Paul vs. Commonwealth Co., 98 F2d 27, 30 (8<sup>th</sup> Cir. 1938) emphasized the context of legislation in dealing with terms such as "gross income," "gross receipts," and "gross proceeds" as being largely dependent upon the context and subject matter in which they are used. As recently as 1971 the Eighth Circuit recognized this authority and conceded that ". . . the term gross income cannot be

said to convey the same definite and inflexible significance under all circumstances and wherever used." Hanson vs. Hunt Oil Co., 438 F2d 690 (8<sup>th</sup> Cir. 1971) (citing the First Trust Co. case).

In the context of the issue stated at the beginning of this section, it is submitted that the statute clearly relates to gross *regulated* revenue in this state. Admittedly, no South Dakota court has passed on this precise question. But many courts have discussed the proposition that while standing alone the term gross revenue clearly relates to all revenues of a company, in the context of a proceeding such as this, it is just as clear that the fundamental reason for the statute deals with the regulated entity under Commission oversight.

Historically, Chapter 49-34A was adopted in 1975 at a time when public utilities dealt only with regulated revenues. This view is also buttressed by the Commission's own interpretation of the administration of the Gross Tax Receipts Fund in SDCL Ch. 49-1A. SDCL § 49-1A-3 levies a tax on public utilities ". . . of not more than .0015 . . . upon the annual intrastate gross receipts derived by the public utility . . . from its customers within the [state] during the preceding year."

The gross receipts which have been taxed have always been the regulated gross receipts of the public utilities. Unregulated revenues have not been subject to the tax. Under this analysis, based upon Exhibit 1 attached (Exhibit B to the Petition) reflecting revenues for the year ended December 31, 2005, the South Dakota portion of total company revenues is 14.72 percent. Based upon the 12 months ended June 30, 2006, that figure is 14.82 percent. See Exhibit 2 attached (produced in response to Staff's data requests). Clearly the threshold in the statute has not been met.

Even if the Commission were to decide to go beyond regulated revenues, the second statutory admonition states that they must be revenues "in this state."

**(B) In This State**

Most cases which discuss any kind of income or revenue "in this state" have done so in the context of taxes. Those cases have generally determined that the term, or a similar term such as "intrastate," has a generally-accepted meaning. For example, in LCI International Telecommunications Corp. vs. State Dept. of Commerce, the court found that the term "intrastate" is clear and unambiguous. 227 Mich. App. 196, 205-06, 574 NW2d 710 (1998). The

Court explained that under the statute at issue, which required assessments to be based on the "gross revenue" derived from "intrastate operations," it was improper to include revenues derived from operations that originated in the state, but ended outside the state. "Such services are interstate operations, not intrastate operations." Id. at 206. Moreover, the terms "interstate" and "intrastate" have "common acceptations from their long-continued use." United Gas Pipeline Co. vs. Miss. Public Service Commission, 241 Miss. 762, 133 S2d 521 (1991). Thus "commerce between two or more states is interstate, and commerce *exclusively within one state* is intrastate." Id. at 776 (emphasis added).

In the present case, delivery of natural gas to customers in other states would not be considered "exclusively within one state," as the common meaning of the term is used. Thus, only South Dakota jurisdictional unregulated revenues, if any unregulated revenues are considered, are relevant to the calculation of the percentage threshold. Because the figures apply equally to this subsection and the next, they are set forth following allocation of revenues.

**(C) Allocation of Revenues**

Cases that have analyzed how or where to allocate a company's revenue have typically done so also with regard to taxes. Only one older South Dakota case discusses the concept of allocating revenue for tax purposes, but the analysis is based on a statutory formula and not helpful to this inquiry. Northwest Finance Co. vs. Nord, 70 S.D. 549, 19 NW2d 578 (S.D. 1945) (Holding that because the bank maintained a North Dakota branch office, its income from the sale of securities, mortgages, and other intangible personal property was not considered South Dakota income.)

Other jurisdictions' interpretations of tax statutes have also discussed the allocation of revenue within the state. One case, for example, discusses whether bananas ultimately transported out of the state of Florida could be considered revenue "within this state" under a Florida income tax apportionment statute. Florida Dept. of Revenue vs. Parker Banana Co., 391 So.2d 762 (Fla. Ct.App.2d Dist. 1980). The Court concluded that "within this state" refers to the *location of the purchaser* and not the place of delivery or the location of the seller. Thus, any income from out-of-state purchasers would be allocated to the purchaser's state,

regardless of whether the actual delivery took place in or out of the state.

In the present case, adoption of this "destination test" would mean that revenue from natural gas sent out of state would be allocated out of South Dakota as long as the purchaser was not a South Dakota resident.

The destination test has found favor in several other states as well. See, e.g., Olympia Brewing Co. vs. Commissioner of Revenue, 326 NW2d 642 (Minn. 1982); Commonwealth of Penn. vs. Gilmour Mfg. Co., 573 Pa. 143, 822 A2d 676 (Pa., 2003); McDonnell Douglas Corp. vs. Franchise Tax Bd., 26 Cal. App. 4th 1789, 33 Cal.Rptr.2d 129 (1994); Texaco, Inc. vs. Groppo, 215 Conn. 134, 574 A2d 1293 (1990); Revenue Cabinet vs. Rohm & Haas, 929 SW2d 741 (Ky. Ct. App. 1996); Pabst Brewing Co. vs. Wisconsin Dept. of Revenue, 130 Wis.2d 291, 387 NW2d 121 (Wis. App. 1986), review denied, 130 Wis.2d 544, 391 NW2d 209 (1986).

As reflected by the authorities cited above, jurisdictional allocation (either by "in state" or allocation of revenues reference) has been widely enforced by the courts. Based upon Exhibit 1 attached, this figure would be 20.84 percent of gross company revenues as of year end 2005. Because of NorthWestern's

restructuring plan adopted in bankruptcy, this figure will continue to decrease because NorthWestern is moving away from unregulated gas sales. The June 30, 2006, figure, according to discovery filed by NorthWestern combining South Dakota regulated and South Dakota unregulated revenues puts the total at 19.78 percent of gross company revenues. See Exhibit 2 attached.

Under either view of the statute, the required 25 percent minimum does not exist and does not confer jurisdiction upon the Commission.

**2. Revenue generated outside the state but allocated to this state by accounting requirements does not constitute "gross revenue in this state."**

As reflected in the discussion above, courts universally have enforced statutory revenue allocation standards. The evidence is clear here that the point of sale of the unregulated gas in Nebraska was in fact in Nebraska. Therefore, the Nebraska sale figures should not be considered.

Even if the Nebraska sale figures are considered, based upon the gradual reduction of unregulated gas sales, and the 12 months ended June 30, 2006, the 25 percent threshold is not even met

including all unregulated gas sales with total South Dakota regulated sales, as demonstrated by Exhibit 2.

**3. Under the only statute which applies, the requisite level of gross revenue does not exist.**

This question was posed in the Petition and is included here for continuity. As discussed in the preceding two sections, the gross revenues relevant to SDCL § 49-34A-38.1 are not sufficient to invoke the Commission's jurisdiction.

To complete the discussion, one final point should be mentioned. Another statute might appear to be implicated, but analysis shows it will not confer jurisdiction. Under SDCL § 49-34A-1(12) a public utility is defined as ". . . any person operating, maintaining, or controlling in this state equipment or facilities for the purpose of providing gas or electric service to or for the public in whole or in part, in this state." BBI is not a public utility, nor does it operate equipment or facilities within the state, under this statute and therefore cannot come within the purview of SDCL § 49-34A-35. That section only confers jurisdiction upon the Commission where one public utility sells all or part of its business to another public utility operating in the state. In any event, the statute would not apply because of

the operation of § 49-34A-38 due to the presence of FERC jurisdiction.

CONCLUSION

Two statutes arguably confer jurisdiction upon the Commission to approve the transaction. The first, does not apply because FERC has approval jurisdiction over the transaction. The second statute involving a 25 percent threshold does not apply because under any view of NorthWestern's gross revenues, less than 25 percent of NorthWestern's gross revenues are generated in the state of South Dakota.

Dated this 14<sup>th</sup> day of September, 2006.

**NORTHWESTERN CORPORATION**

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CERTIFICATE OF SERVICE

David A. Gerdes of May, Adam, Gerdes & Thompson LLP hereby certifies that on the 14<sup>th</sup> day of September, 2006, he mailed by United States mail, first class postage thereon prepaid, a true and correct copy of the foregoing in the above-captioned action to the following at their last known addresses, to-wit:

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David A. Gerdes

**NorthWestern Corporation**  
**FERC basis revenue-South Dakota**  
**Year ended December 31, 2005**

South Dakota Electric	104,318,847
South Dakota Gas	55,290,157
Total SD regulated	<u>159,609,005</u>

Total NorthWestern FERC basis revenue	<u>1,084,668,143</u>
---------------------------------------	----------------------

SD regulated revenue as percent of FERC basis revenue	14.72%
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**Revenues of non-regulated SD operations**

NorthWestern Services Corporation	152,870,155
Nekota Resources, Inc.	1,200,537
Total	<u>154,070,692</u> See note below

Note-The revenues of these subsidiaries are not included in total FERC revenues, because FERC requires presentation of subsidiaries on the equity method of accounting.

	<b>NPS Revenue</b>
FERC IS	214,975,502
SEC IS	<u>214,975,502</u>

SD Electric	104,318,847
SD Gas	55,290,157
NE Gas	55,366,497
	<u>214,975,502</u>

Calculation 1

159,609,005	total SD regulated
154,070,692	all unregulated gas
313,679,697	total
<u>1,261,354,865.31</u>	total co grossed up revenues
<u>24.87% %</u>	

Calculation 2

159,609,005	total SD regulated
154,070,692	all unregulated gas
313,679,697	total
<u>1,243,473,483.43</u>	total co grossed up revenues less adjustments
<u>25.23% %</u>	

Calculation 3

159,609,005	total SD regulated
99,535,692	just SD unregulated (exclude Nebraska)
259,144,697	total
<u>1,243,473,483.43</u>	total co grossed up revenues less adjustments
<u>20.84% %</u>	

**NorthWestern Corporation**  
**FERC basis revenue-South Dakota**  
**12 Months ended June 30, 2006**

South Dakota Electric	107,490,002
South Dakota Gas	58,462,933
Total SD regulated	<u>165,952,936</u>

Total NorthWestern FERC basis revenue 1,119,486,662

SD regulated revenue as percent of FERC basis revenue 14.82%

**Revenues of non-regulated SD operations**

NorthWestern Services Corporation	121,744,955
Nekota Resources, Inc.	1,219,796
Total	<u>122,964,751</u> See note below

Note-The revenues of these subsidiaries are not included in total FERC revenues, because FERC requires presentation of subsidiaries on the equity method of accounting.

SD Electric	107,490,002
SD Gas	58,462,933
NE Gas	60,188,803
	<u>226,141,738</u>

Calculation 1	165,952,936	total SD regulated
	122,964,751	all unregulated gas
	288,917,687	total
		total co grossed up
		revenues

1,254,968,842.00  
23.02%

Calculation 2	165,952,936	total SD regulated
	122,964,751	all unregulated gas
	288,917,687	total
		total co grossed up
		revenues less
		adjustments

1,211,945,082.00  
23.84%

Calculation 3	165,952,936	total SD regulated
	73,795,676	just SD unregulated
	239,748,612	(exclude Nebraska)
		total
		total co grossed up
		revenues less
		adjustments

1,211,945,082.00  
19.78%