

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

Forrest L. Hatfield,)	
)	
Complainant,)	<u>Case No. WC-2006-0128</u>
)	
v.)	
)	Consolidated with
Melody Lake Water & Sewer, LLC,)	Case No. WC-2006-0130 and
)	Case No. WC-2006-0152
Respondent.)	

**STAFF'S REPORT REGARDING
ISSUES RAISED BY THE PLEADINGS**

COMES NOW the Staff of the Missouri Public Service Commission and, for its Report Regarding Issues Raised by the Pleadings, states to the Missouri Public Service Commission as follows:

1. On September 28, 2005, the Commission issued separate Orders Directing Staff Investigation in Case No. WC-2006-0128 and Case No. WC-2006-0130, wherein it directed the Staff to investigate the issues set out in the pleadings and to file reports of its findings by no later than November 14, 2005. On November 10, 2005, the Commission issued its Order Consolidating Cases, wherein it consolidated the said two cases with Case No. WC-2006-0152, with Case No. WC-2006-0128 being the lead case, and ordered the Staff to file one joint report for the consolidated cases.

2. Attached hereto as Appendix A is the Staff Report of Investigation, which is being submitted in compliance with the above-mentioned orders of the Commission.

WHEREFORE, the Staff respectfully submits the attached Report of Investigation for the Commission's consideration in this case.

Respectfully submitted,

DANA K. JOYCE
General Counsel

/s/ Keith R. Krueger

Keith R. Krueger
Deputy General Counsel
Missouri Bar No. 23857

Attorney for the Staff of the
Missouri Public Service Commission
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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 14th day of November 2005.

/s/ Keith R. Krueger

**STAFF REPORT OF INVESTIGATION
CASE NO. WC-2006-0128 ET AL.**

Prepared By:

**James A. Merciel, Jr., P.E.
Water & Sewer Department
Utility Operations Division**

November 14, 2005

Overview of the Complaints

There are three formal complaints filed against an entity known as Melody Lake Water & Sewer, LLC (the LLC), although one of the complaints refers to the subject entity as Melody Water and Sewer, and another names the three individuals who operate the LLC. Forrest L. Hatfield filed Case No. WC-2006-0128, and Robert G. Bodine filed Case No. WC-2006-0130, both of those submitted on September 23, 2005. Harold Reitz filed Case No. WC-2006-0152 on October 5, 2005. The LLC has responded to each of the complaints by having an attorney submit an entry of appearance in each of the subject cases, in which it was requested that the complaints be resolved through voluntary mediation as provided for by the Commission's complaint procedures.

The complaints generally allege the following:

- (1) That the LLC was set up in an unauthorized manner by officers of Melody Lake Ranch Associates, which is a subdivision homeowners association (the Association);
- (2) That the LLC acquired the assets of a regulated utility known as Franklin County Service Company (FCSC), with no authority to do so;
- (3) That the LLC has raised rates for water and sewer service with no authority to do so; and
- (4) That the LLC has created issues that have caused non-compliance with Department of Natural Resources regulations.

On September 28, 2005, the Commission issued an Order Directing Staff Investigation in two of the subject cases, Case Nos. WC-2006-0128 and WC-2006-0130. However, additionally, on November 10, 2005 the Commission issued an order consolidating the three subject complaint cases, with Case No. WC-2006-0128 being designated the lead case, and ordering the Staff to file one report for these consolidated cases. This report is intended to comply with that Order.

History and Overview of Franklin County Service Company

Melody Lake Ranch is a subdivision in Franklin County near Leslie, MO that was developed in the 1960s. Franklin County Service Company (FCSC) became certificated as a water utility in Melody Lake Ranch in Case No. 16,492 on June 13, 1968. In Case No. 16,526, FCSC sought to acquire certain existing sewer assets, and it became certificated as a sewer utility in Case No.

16,529 on July 24, 1968. FCSC remains certificated today, with approximately 52 water customers and 65 sewer customers. FCSC was owned and operated by Harold Horsley for many years until his death sometime in 2002. Ill health caused problems with the business for some time before his death as well, both with regard to operation of the facilities, and administrative paperwork. The last annual report filed with the Commission was the calendar year 1997 report. Assessments through the 2004 fiscal year are paid. There are no assessments shown as due for 2005 and 2006, but that is based on zero reported revenue. FCSC also became administratively dissolved as a corporation on February 13, 2004.

During Mr. Horsley's declining health, the homeowners in the subdivision began operating the utility systems. During 2002, Mr. Robert (Bob) White, who at the time was the president of the Association, initiated contact with the Staff to discuss the possibility of the homeowners, or presumably more specifically the Association, permanently acquiring the water and sewer systems. There were a few telephone conversations between the Staff and Mr. White, some correspondence with financial information, and one meeting between the Staff, Mr. White, and Mr. Gerald (Jerry) Johnston, who was the vice president of the Association at the time. More recently, Mr. Johnston has become the president of the Association, and a few more telephone conversations have taken place between him and the Staff. Discussions during this time addressed the fact that the homeowners could operate as a non-regulated utility, the need for some type of contract to transfer assets from FCSC to the Association, which perhaps would follow probate action and the handling of Mr. Horsley's estate, and the need for the Commission to approve such a transfer of assets along with cancellation of FCSC's certificates and tariffs.

The Staff expected that, barring any complications of probate action, a fairly simple transfer of assets could take place, and that either Mr. Horsley's estate or the Association or both would file what is sometimes commonly called a "sale case," seeking authorization to transfer assets and cancel FCSC's certificates and tariffs. The Staff offered to assist in reviewing documents and getting a proper filing prepared. However, the homeowners sent copies of documents indicating a sale of the assets of FCSC to the LLC had taken place. The Staff did not, until then, know that the LLC existed. An Asset Purchase Agreement, dated July 15, 2004 and signed February 3, 2005 is purported documentation of a transfer of assets. This document is included as Attachment 1. The seller in this agreement is FCSC, the purchaser is the LLC, and the person who signed for both seller and purchaser is Gerald L. Johnston. In addition, a General Warranty Deed dated March 11, 2005 purports to transfer several parcels of real estate, with FCSC as the Grantor and the LLC as the Grantee. This document is included as Attachment 2. Jerry Johnston signed this document as president of FCSC. Apparently, the executor of Mr. Horsley's estate transferred the stock of FCSC to Mr. Johnston, and maybe others as well. There are no records on the Secretary of State's website that indicate any change of registered agents or officers of FCSC, or reinstatement of FCSC's corporate status.

So, to summarize the current status of the FCSC: it is apparently owned by one or more people who are officers of the Association; it is active as a regulated water and sewer utility, but has transferred its assets and ceased providing utility service without authorization to do so; it is not

current on the submission of its Commission annual reports; and it is administratively dissolved as a corporation.

Issues to be Addressed

The Staff believes that substantially everyone involved in this matter wishes to see FCSC decertificated, with assets transferred to, and utility service provided in some legitimate manner by, the homeowners who are also the customers. Recognizing that the by-laws of the Association, and actions of its board members (even those that may have allegedly been improper with regard to the by-laws) do not fall directly within the jurisdiction of the Commission, the Staff believes that the resolution to these complaints would be to ensure that either the Association, the LLC or some other entity is properly set up to provide utility service under the control of the homeowners/customers, and for the Commission to then grant approval of a transfer of assets and cancel FCSC's certificates and tariffs. Normally this is the purpose of a sale case, although for expediency this action could perhaps be accomplished in the context of these formal complaints.

The Staff believes that the Association would be the logical entity to also be the utility. However, if the Association wishes to set up a separate entity, such as the LLC, that is also acceptable so long as the LLC is legitimately controlled by the Association, meaning ultimately by the homeowners/customers. If the LLC were not under the direct control of the Association, then it may need to become a nonprofit utility as provided by state statutes, specifically Section 393.825 for sewer and Section 393.900 for water, along with some additional sections following each. The provisions in the statutes have certain corporate setup requirements which include not-for-profit status, a minimum number of board members and being a member corporation. Currently, the LLC may not meet some of these requirements.

The Missouri Department of Natural Resources (DNR) has issues that pertain to the Melody Lake water and sewer systems with regard to construction of pipeline extensions, which have been ongoing for several years and pre-date the LLC. This includes constructing facilities without proper construction permits and improper installation of facilities, which includes buried manholes (making them inaccessible), inadequate manhole construction, and improper or inadequate pipeline depth and location. DNR has a compliance schedule that requires FCSC or perhaps its successor to submit certain permit applications, and to prepare "as-built" plans and maps. While there have been meetings and correspondence between DNR and the people presently operating the systems, and some progress has been made, the issues are not resolved. Further, it is not certain, based on the Staff's conversations with DNR people, that the compliance schedule is being met in a timely fashion.

Although it is not entirely clear to the Staff, there may be communication issues between the Association board and its members, since at least some members believe that board members are acting without regard to the Association's by-laws or the wishes of the Association's members. In addition to the apparent failure of FCSC to meet regulatory requirements with regard to providing utility service and transferring assets without authorization, the Staff has not been able

to obtain copies of any records or board meeting minutes of the Association that document decisions regarding the formation of the LLC, the acquisition of FCSC's stock by the Association or the LLC, or the transfer of FCSC's assets to the Association or the LLC, nor any documentation of a transfer of stock of FCSC. Although the behavior of the Association's board of directors, as stated, is not directly within the Commission's jurisdiction, it appears that if there were adequate communication, good representation on the members' behalf, and compliance with the Association's by-laws, then these formal complaints probably would not exist.

Staff's Conclusions

Mediation may be the best solution to the communication issues between the LLC and/or the Association and the members of the Association, to the extent that such issues actually exist. However, since the regulated company, FCSC, is apparently no longer operating, the Staff believes that FCSC and the LLC and/or the Association should either prepare and file a sale case, or alternatively should submit in these formal complaints all of the appropriate information that would be included in a sale case. That information would include, but not necessarily be limited to, appropriate board decision records of each involved entity regarding disposal or acquisition of assets, how the acquiring utility will be operated under the control of the homeowners/customers, a tax impact statement, and a request by FCSC to cancel its certificates and tariffs after the Commission approves the asset transfer and all required actions are accomplished.

Whether in the context of these formal cases or a separate sale case, the homeowners need to be informed of what action is being proposed (or has already been done), including proposals for changes in rates, if any, and any planned improvements to the facilities. Such information also needs to be documented in order for the Staff to make a recommendation, and for the Commission to make an informed decision, regarding the approval of a transfer of assets and the cancellation of FCSC's certificates and tariffs.

ASSET PURCHASE AGREEMENT

This ASSET PURCHASE AGREEMENT (“agreement”) dated this 15 day of July, 2004, by and between MELODY LAKE WATER & SEWER LLC (“Purchaser”) and FRANKLIN COUNTY SERVICE COMPANY (“Seller”)

WITNESSETH:

WHEREAS, Seller owns and operates a utility company providing water and sewer service exclusively to Melody Lake Ranch Subdivision, Franklin County Missouri and conducts such business under the name of Franklin County Service Company;

WHEREAS, the parties desire to provide for the sale and transfer of the business, **including the personal property located at, used in connection with, or arising out of such Business, together with the real estate utilized in the Business**, in exchange for the relinquishment of debts and services provided by Buyer, and upon the terms and subject to the conditions herein set forth; and

WHEREAS, this Agreement sets forth the terms and conditions to which the parties have agreed and further contemplates the execution and delivery of certain documents and deeds, all as hereinafter described.

NOW, THEREAFTER, in consideration of the promises and mutual covenants, agreements, representations and warranties herein contained, the parties intending to be legally bound hereby agree as follows:

ARTICLE I

Section 1.1 - Transfer of Assets - Subject to the terms and conditions of this agreement, Seller does hereby agree to sell, transfer and convey and deliver to Purchaser, and Purchaser does hereby agree to purchase and accept from Seller the following property and rights:

- a) all water and sewer lines, valves, pumps, lift stations, equipment, meters, reservoirs, lagoons, water towers, pump houses and accounts receivable used in connection with the operation or arising out of the business, including without limitation the items set forth on Schedule A & B of this Agreement:
- b) all licenses, permits, easements or rights of easements, prescriptive easements, rights of egress and ingress, supplies and work in progress of the Seller in the operation of the Business as well as all contractual rights of the Business, bank accounts and cash therein and any and all interest to water and sewer fees accrued in the past, present or future:
- c) all account ledgers, record books, copies of deeds or any and all other business records generated in the operation of the Business:
- d) All real property set forth in Schedule B:

All property to be sold and transferred by Seller to Purchaser described above and herein shall be hereinafter collectively referred to as the "Assets". In addition by separate deeds, Seller agrees to contemporaneously convey to Purchaser the real property owned by the Business located in Franklin County Missouri and set forth in Schedule B which is attached hereto and incorporated herein by this reference.

Section 1.2 - Consideration for Assets Payable at the Closing - In reliance on the representations and warranties of Seller herein contained, and on the terms and subject to the conditions of this Agreement, Purchaser, in consideration for the transfer and delivery to it of the Assets as herein provided, will as and for consideration cancel the debt for services and material provided to Seller, at the time of closing in the amount of Eleven Thousand Nine Hundred Dollars (\$11,900)(the "Purchase Price". Purchaser will pay any sales, use or transfer taxes incurred by this transaction.

Section 1.3 - Assumption of Liabilities - Except as specifically set forth below in this Section, Purchaser shall not assume and does not agree to pay, perform or discharge any debt, expense or liability of Seller of any nature whatsoever, whether fixed or contingent. From and after the Closing date, Purchaser agrees to perform the service previously provide by Seller.

Section 1.4 - Effective Date and Time - The effective date and time of the transfer of the

Assets shall be at 12:01 a.m. on the closing date of August 2, 2004.

ARTICLE II

Section 2.1 - Closing - The closing of the transaction provided for in this Agreement (the "Closing") shall take place at the offices of Hansen, Stierberger, Downard, Melenbrink & Schroeder, 80 North Oak Street, Union, MO 63084 on the 2nd day of August, 2004, or at such other time and date as the parties shall mutually agree.

Section 2.2 - Instruments of Conveyance and Transfer - At the Closing, Seller shall deliver to purchaser such deeds, bills of sale, endorsements, assignments and other good and sufficient instruments of transfer, conveyance and assignment as shall be effective to vest in Purchaser good and marketable title to the Assets, free and clear of all liens, claims, and encumbrances. Seller shall take all steps as may be required to put Purchaser in actual possession and control of the Assets and the Business as of the Closing.

ARTICLE III

Section 3.1 - Title and Condition of Assets - Seller has good and marketable title to all of the Assets subject to no mortgage, lien, security interest, easement, right-of-way, or to any other encumbrance. All items of personal property are being sold AS-IS, where-is condition. Seller offers no warranties either express or implied and expressly disclaims any and all warranties whatsoever implied by law.

Section 3.2 - Environmental Matters - Seller has all permits and approvals necessary for Seller to conduct the Business as now being conducted. Seller is informed and believes it has operated and is presently operating in compliance with all applicable federal, state and local environmental statutes and regulations and to Seller's actual knowledge, there is no existing regulatory requirement with a future compliance date that will require operational changes or capital expenditure at the Business. Seller is not actually aware that any "Hazardous Substance," as that term is defined in the Federal Comprehensive Environmental Response, Compensation and Liability Resource Conservation and Recovery Act, is present, has been leaked, spilled deposited or otherwise released on the real property. Seller is not

aware of any asbestos, PCB's, or underground storage tanks on or in the real property.

ARTICLE IV

Section 4.1 - Authority - Purchaser is fully authorized to deliver and perform this Agreement. No other or additional consent or authorization is required by law. The Closing of the transaction contemplated by this agreement will not result in a breach, violation, or default by Purchaser of or under any judgement, decree, mortgage, agreement, indenture, or other instrument applicable to Purchaser. Upon execution and delivery hereof, this agreement shall constitute the valid and binding obligation of Purchaser enforceable in accordance with its terms.

Section 4.2 - Further Assurances - From time to time after the Closing, at the request of the Purchaser, and without further consideration, Seller will execute and deliver such additional instruments and will take such other actions as Purchaser reasonably may require to convey, assign, transfer and deliver the Assets and the Business and otherwise carry out the terms of this Agreement.

Section 4.3 - Bulk Sales Compliance - Purchaser hereby waives compliance by Seller with the Bulk Transfer Provisions of the Uniform Commercial Code as in effect in the State of Missouri to the extent such laws may be deemed applicable to the transaction.

Section 4.4 - Entire Agreement - This Agreement embodies the whole agreement of the parties. There are no promises, terms, conditions, or obligations other than those contained herein. This Agreement shall be construed and enforced in accordance with the laws of the State of Missouri.

IN WITNESS WHEREOF, the undersigned parties hereto have duly executed this Agreement on the date first above written.

SELLER:

PURCHASER:

BY: *Gerald L Johnston*

BY: *Gerald L Johnston*

DATE: *2/3/05*

DATE: *2/3/05*

EXHIBIT "A"

Water tower

Pumps

Trunk lines

Hydrants

Shut-off vales

Tools

Manholes

Manhole covers

Meters

All personal property associated with the operation of the sewer and water line facilities and plants

EXHIBIT "B"

TRACT 1:

A tract of land being part of the South half of the Northwest Quarter and part of the North half of the Southwest Quarter of Section 27, Township 42 North, Range 3 West in Franklin County, Missouri being more fully described as follows: Commencing at a concrete post at the Northeast corner of lot L36 of Melody Lake Subdivision; thence S 75 degrees 44' E 119.0 feet; thence S 4 degrees 54' E on the east side of a roadway over the dam of Melody Lake 1,183.72 feet to the point of beginning; thence N 21 degrees 32' E 134.7 feet to an iron pipe; thence N 5 degrees 43' W 502.32 feet; thence S 75 degrees 00' E 348.50 feet to an iron pipe; thence N 84 degrees 37' E 377.49 feet; thence S 2 degrees 32' E 321.25 feet; thence S 84 degrees 54' W on the property line 625.40 feet to an iron pipe; thence S 21 degrees 32' W 268.2 feet; thence N 4 degrees 54' W 56.08 feet to the point of beginning, containing 5.70 acres more or less as per survey by Norbert Wunderlich recorded in Surveyor's Record 24, Page 210.

TRACT 2:

Lots 16 and 52 of the FIRST ADDITION TO MELODY LAKE SUBDIVISION as per plat thereof recorded in Plat Book J, Page 60 of the records of the Recorder of Deeds of Franklin County, Missouri.

TRACT 3:

A lot in THE 1ST ADDITION TO MELODY LAKE SUBDIVISION and designated RESERVED as per plat thereof found in Plat Book J, Page 60, found in the records of the Recorder of Deeds of Franklin County, Missouri.

TRACT 4:

Lots 11, 27, 65, 85 and 86 of the SECOND ADDITION to MELODY LAKE SUBDIVISION as per plat thereof recorded in Plat Book K, page 3 of the records of the Recorder of Deeds of Franklin County, Missouri.

SHARON L. BIRKMAN
RECORDER OF DEEDS
FRANKLIN COUNTY
STATE OF MISSOURI



PAGES: 3
FEE: \$30.00
REFERENCE #
DATE: 04/18/2005
TIME: 04:16PM

2005-09009

CK 10076-30.00

GENERAL WARRANTY DEED

Date: March 11, 2005

Grantor: FRANKLIN COUNTY SERVICE COMPANY

Address: 13930 Manchester Road - St. Louis, MO 63011

Grantee: MELODY LAKE WATER & SEWER, LLC

Address: 333 Playmor Drive - Leslie, MO 63056

This Deed Witnesseth, that as of the above date, the above Grantor for and in consideration of One and more Dollars in hand paid, does by these presents, GRANT, BARGAIN and SELL, CONVEY and CONFIRM unto the above Grantee, its heirs or successors and assigns, the following described land situated in Franklin County, Missouri, to-wit:

SEE ATTACHED LEGAL *Page 3*

TO HAVE AND TO HOLD, the same together with all rights and appurtenances to the same belonging, unto the said Grantee and to the heirs or successors and assigns of such Grantee forever. The said Grantor hereby covenanting that said Grantor and the heirs and personal representatives of said Grantor shall and will WARRANT and DEFEND the title to the premises unto the said Grantee, and to the heirs, successors and assigns of such Grantee forever, against the lawful claims of all persons whomsoever, excepting, however, the general taxes for the calendar year 2004 and thereafter, and special taxes becoming a lien after the date of this deed.

IN WITNESS WHEREOF, the Grantor has executed these presents the same effective as of the day and year first above written.

FRANKLIN COUNTY SERVICE COMPANY

BY: *Jerry Johnston*
JERRY JOHNSTON, President

BY: *Pat Smits*
PAT SMITS, Secretary

STATE OF MISSOURI, County of Franklin, ss.:

On March 11, 2005, before me personally appeared JERRY JOHNSTON, President, and PAT SMITS, Secretary, to me personally known to be the persons described in and who executed the foregoing instrument, and acknowledged that they executed the same as their free act and deed.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed my official seal in the County and State aforesaid, the day and year last above written. I am commissioned in Franklin County, Missouri.

Jonathan L. Downard
Notary Public - Jonathan L. Downard
Franklin County, MO

My Comm. Expires: 4/16/05



TRACT 1:

A tract of land being part of the South half of the Northwest Quarter and part of the North half of the Southwest Quarter of Section 27, Township 42 North, Range 3 West in Franklin County, Missouri being more fully described as follows: Commencing at a concrete post at the Northeast corner of lot L36 of Melody Lake Subdivision; thence S 75 degrees 44' E 119.0 feet; thence S 4 degrees 54' E on the east side of a roadway over the dam of Melody Lake 1,183.72 feet to the point of beginning; thence N 21 degrees 32' E 134.7 feet to an iron pipe; thence N 5 degrees 43' W 502.32 feet; thence S 75 degrees 00' E 348.50 feet to an iron pipe; thence N 84 degrees 37' E 377.49 feet; thence S 2 degrees 32' E 321.25 feet; thence S 84 degrees 54' W on the property line 625.40 feet to an iron pipe; thence S 21 degrees 32' W 268.2 feet; thence N 4 degrees 54' W 56.08 feet to the point of beginning, containing 5.70 acres more or less as per survey by Norbert Wunderlich recorded in Surveyor's Record 24, Page 210.

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