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Witness: *Keith Majors*
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Case No.: *WR-2023-0006*
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MISSOURI PUBLIC SERVICE COMMISSION

FINANCIAL AND BUSINESS ANALYSIS DIVISION

AUDITING DEPARTMENT

SURREBUTTAL TESTIMONY

OF

KEITH MAJORS

CONFLUENCE RIVERS UTILITY OPERATING COMPANY, INC.

CASE NO. WR-2023-0006

Jefferson City, Missouri
July 2023

** Denotes Confidential Information **

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SURREBUTTAL TESTIMONY OF

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CONFLUENCE RIVERS UTILITY OPERATING COMPANY, INC.

CASE NO. WR-2023-0006

Q. Please state your name and business address.

A. Keith Majors, Fletcher Daniels Office Building, 615 East 13th Street, Room 201, Kansas City, Missouri, 64106.

Q. By whom are you employed and in what capacity?

A. I am a Utility Regulatory Audit Supervisor employed by the Staff ("Staff") of the Missouri Public Service Commission ("Commission").

Q. Are you the same Keith Majors who previously provided testimony in this case?

A. Yes. I provided direct testimony in this case on May 26, 2023 concerning Staff's revenue requirement recommendation and other various adjustments and topics. I provided rebuttal testimony on June 29 concerning updates and corrections to Staff's revenue requirement recommendation.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of this surrebuttal testimony is responding to the rebuttal testimony of Confluence Rivers Utility Operating Company, Inc. ("Confluence") witness Brent Thies.

Q. Please provide a brief summary of your surrebuttal testimony.

A. My surrebuttal testimony responds to portions of Mr. Thies' testimony, Section VI, "Rate Base Including Acquisition Costs." concerning the "Retired Asset Values" and "Acquisition-Related Cost Disallowed." I also reserve the right to supplement my testimony once Staff receives materials from US Water Systems, LLC ("US Water") and Central States Water Resources, Inc.'s ("CSWR") board meetings.

DISCOVERY ISSUES

Q. Has Staff received full and complete discovery regarding board of directors' meeting materials from Confluence's parent companies, US Water and CSWR, for board meetings that occurred between October 1, 2019, and April 30, 2023?

A. No. My understanding is that Staff asked the Commission to compel Confluence to respond to Staff Data Request ("DR") No. 0231.1, which requests these materials. On June 26, Staff filed a *Motion to Compel* ("Motion"). The Motion requested that Confluence provide a response to DR No. 0231.1. That DR requested all of US Water's and CSWR's board of directors meeting minutes, agendas, and all materials for the period of October 1, 2019 through April 30, 2023. I have attached a copy of this DR as Confidential Schedule KM-s1. On July 12, the Commission issued its *Order Denying in Part and Granting in Part Staff's Request to Compel Discovery Answers*. Although the Commission ordered Confluence to respond to DR No. 0231.1,[1] Staff's attorneys and Confluence's attorneys do not agree on the scope of the order and Staff finds Confluence's response deficient. For this reason, Staff has not received the requested board materials.

Q. Do you reserve the right to file supplemental testimony once Staff has received these materials?

A. Yes.

[1] *Order Denying in Part and Granting in Part Staff's Request to Compel Discovery Answers*, page 8.

RETIRED ASSET VALUES

Q. On page 8 beginning on line 14 of his rebuttal testimony, Mr. Thies references assets that were retired that did not include a corresponding asset value in utility plant in service. What are these assets?

A. These assets are in the Gladlo, Missouri Utilities, Roy-L, Terre Du Lac, and Villa Ridge systems. Staff reviewed the response to DR No. 0088 detailing the plant additions and retirements, and the annual reports to identify the corresponding additions. Staff could not identify where Confluence listed the additions that corresponded to the retirements that were listed in DR No. 0088. According to discussions with Confluence, these assets were not included in the property transferred to Confluence upon acquisition, which would explain why the retirement was recorded less than five months after the acquisition.

Q. Do you currently have a change to the plant or reserve balances related to these discrepancies?

A. No, but Staff will continue to discuss this issue with Confluence to resolve this issue.

PLANT ADDITIONS

Q. Has Staff, subsequent to the accounting schedules identified in your rebuttal testimony, identified plant additions that should be included?

A. Yes. The original response to DR No. 0088 requested plant additions from January 1, 2019, through the present. The Hillcrest, Indian Hills, and Raccoon Creek systems filed for rate increases or were acquired prior to 2019 and had additions that were not included in Staff's updated accounting schedules. Staff requested DR No. 0088.1 for the additions and retirements prior to 2019. Staff has included the plant, reserve, and depreciation expense, as appropriate and adjusted for acquisition costs and repairs, for these additions in Staff's accounting schedules.

ACQUISITION-RELATED COSTS DISALLOWED

Q. On page 10, beginning on line 1 of his rebuttal testimony, Mr. Thies references acquisition-related costs. Generally, what costs are incurred in completion of an acquisition?

A. There are two general categories, transaction and transition costs. Transaction costs include investment banker fees, and consulting and legal fees associated with the evaluation, bid, negotiation and structure of the deal.[2]

Transition costs are costs incurred to integrate the acquired utility into the acquiring entity. These costs are necessary to ensure that the synergy savings are achieved and that the merger process is effective. These costs can include severance and retention costs and costs associated with process integration.[3]

The Commission thoroughly described and evaluated transition and transaction costs in the *Report and Order* in Case No. EM-2007-0374, *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc. for Approval of the Merger of Aquila, Inc. with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief*.[4]

Q. What are synergy savings?

A. Synergy savings are reductions in costs from combining the operations of merging utilities as compared to the combined costs of the entities standing alone. Examples

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[2] *Report and Order*, Case No. EM-2007-0374, Page 78, footnotes omitted.
[3] *Ibid*.
[4] It is noteworthy that, like Confluence's numerous acquisitions, Aquila, Inc. was a "distressed" utility suffering from numerous financial perils including a below investment grade debt rating.

of synergy savings include benefits of scale, improved efficiency in support functions, economies of scale in purchasing, and savings from combining customer service and field operations in the same geographic area.[5]

Q. On page 10, lines 8-12 of his rebuttal testimony, Mr. Thies gives several examples of the acquisition-related costs. In your opinion, are these transaction costs or transition costs?

A. These costs are appropriately categorized as transaction costs. I will discuss each in turn with the descriptions used by Mr. Thies.

On line 7, page 10, Mr. Thies lists "necessary legal and engineering expenditures directly related to the acquisitions." These are most analogous to the due diligence that an acquiring company completes prior to acquiring the utility. Mr. Thies describes the expenditures further on lines 8 through 12:

> These costs include expenditures that allow the Company to determine the feasibility of capital improvements that will need to be made to the system. They also include the legal and other costs associated with securing clean title to the property, confirming proper easement access to the system components, and the costs to appropriately file required acquisition documentation with the Commission.

Feasibility studies to evaluate potential projects related to the evaluation of a potential acquisition are not eligible for capitalization. Any costs to secure clean title to the property are costs of ownership. Lastly, any costs related to the filing of an acquisition case before the Commission are owner's costs as there is no benefit to ratepayers for these costs and these costs are not required for utility service.

Q. How are transaction costs recovered by utilities?

[5] *Ibid*, Page 79.

A. Generally, these costs are not recovered in rates as noted in the EM-2007-0374 *Report and Order*:

> 351. Transaction costs are generally not recovered through rates but rather charged to shareholders because transaction costs consist of costs incurred by both the acquiring company as well as the acquired company to complete the transaction, and not to facilitate the provision of utility service – such costs are properly considered to be a part of the purchase price of the acquisition. [footnote omitted]
>
> 352. Absent the specific rate and accounting treatment being requested by the Applicants, pursuant to Generally Accepted Accounting Principles, transaction costs would be added to the value of the consideration being given by Great Plains for the Aquila stock being acquired to arrive at the total purchase price of the transaction. [footnote omitted]
>
> 353. Transaction costs do not meet the normal criteria for traditional expenses used to establish rates. These costs are not used or useful nor necessary for the provision of safe and adequate service. These costs are investor costs incurred in the buying and selling of their stock. These are the costs of a non-regulated holding company. Great Plains and its Board decided to incur these costs. Recovery of these transaction costs would result in regulated utilities subsidizing their non-regulated parent companies. [footnote omitted]

As the Commission determined, acquisition transaction costs are not eligible for inclusion in cost of service.

Q. From a rate base valuation perspective, why should transaction costs not be recovered?

A. The intent of protecting ratepayers from providing unreasonable returns to utilities would be circumvented if rates were developed by considering a return on investments above net depreciated original costs. This concept has been described as being the net original cost rule and the Commission has more fully articulated this rule as follows:

> As a general rule, only the original cost of utility plant to the first owner devoting the property to public service, adjusted for depreciation, should be included in the utility's rate base. That principle is known as the net original cost rule. The net original cost rule was developed in order to protect ratepayers from having to pay higher rates simply because ownership of utility plant has changed, without any actual change in the usefulness of the plant. If a utility were allowed to revalue its assets each time they changed hands, it could artificially inflate its rate base by selling and repurchasing assets at a higher cost, while recovering those costs from its ratepayers. Thus, ratepayers would be required to pay for the same utility plant over and over again. The sale of assets to artificially inflate rate base was an abuse that was prevalent in the 1920s and 1930s and such abuses could still occur.[6]

Q. On page 10, lines 13-22 of his rebuttal testimony, Mr. Thies references the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts for Class A & B Water and Wastewater ("USOA") account 183 – Preliminary Survey and Investigation Charges, and the Company's procedure to charge this account for the expenses at issue. Does this procedure represent proper accounting?

A. No. The response to Staff DR No. 0066.1 specifically states regarding the acquisition costs: "Expense is booked to account 183 prior to acquisition. Upon closing, expenses are booked to 107 and any expense in 183 related to the acquired system are moved to 107." Costs incurred prior to the acquisition, such as these, are clearly related to the evaluation and due diligence on behalf of Confluence in determination of bid amount and terms of the offer. These costs are property retained at the Confluence ownership level, or booked "below the line" and not recovered in the cost of service.

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[6] Case No. EM-2000-292, Second Report and Order, *In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & Power Company with and into UtiliCorp United Inc., and, in Connection Therewith, Certain Other Related Transactions*, 12 Mo.P.S.C.3d 388, 389-90 (2004), effective March 7, 2004.

Q. If the feasibility studies were subsequently used in part or whole in the completion of a construction project, should the costs of those studies be charged to Account 183 and subsequently to the appropriate utility plant account?

A. No. These costs were incurred on behalf of the purchaser (Confluence shareholders) and would not be incurred but for the determination of bid amount and terms of the offer. If Confluence chose not to acquire the subject utility there would be no recourse for these costs as they are incurred by and benefit the purchaser (Confluence shareholders).

Q. On page 12, lines 4-14 of his rebuttal testimony, Mr. Thies references costs similar to the acquisition costs included in prior rate cases. Are these comparable costs?

A. No. Staff did include some deferred maintenance costs for leak repairs, line location, smoke testing, and sludge removal for the Indian Hills, Elm Hills, and Raccoon Creek systems. These costs were deferred and amortized over 5, 10, or 20 years as applicable. These costs differ from those at issue here because they were specifically agreed to in a disposition agreement in the applicable cases. As Mr. Thies notes on page 28, lines 15-20 of his rebuttal testimony concerning Stipulation and Agreements, it is uncertain what the parties to the disposition agreement may have conceded in agreeing to defer and amortize these expenses.

More importantly, Confluence was never given carte blanche authority by the Commission to defer acquisition costs. I am not aware of any utility acquisition in which the Commission has authorized or Staff has recommended deferral of transaction costs.

Q. Does this conclude your surrebuttal testimony?

A. Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Confluence Rivers Utility Operating Company, Inc.'s Request for Authority to Implement a General Rate Increase for Water Service and Sewer Service Provided in Missouri Service Areas	)))))	Case No. WR-2023-0006

AFFIDAVIT OF KEITH MAJORS

STATE OF MISSOURI)
) ss.
COUNTY OF JACKSON)

COMES NOW KEITH MAJORS and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Surrebuttal Testimony of Keith Majors*; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

Keith Majors

KEITH MAJORS

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Jackson, State of Missouri, at my office in Kansas City, on this 18th day of July 2023.

M. Ridenhour

Notary Public

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

M. RIDENHOUR
My Commission Expires
July 22, 2023
Platte County
Commission #19603483

SCHEDULE KM-s1

HAS BEEN DEEMED

CONFIDENTIAL

IN ITS ENTIRETY