

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

In the Matter of the Joint Application of )  
Missouri-American Water Company and Cedar )  
Hill Utility Company, Inc. for Authority )  
for Missouri-American Water Company to ) Case No. SM-2004-0275  
Acquire Certain Assets of Cedar Hill Utility )  
Company, Inc., and, in Connection Therewith, )  
Certain Other Related Transactions. )

**RESPONSE TO STAFF RECOMMENDATION**

COMES NOW Missouri-American Water Company (“MAWC” or the “Company”), and, in response to the Staff Recommendation, states as follows to the Missouri Public Service Commission (“Commission”):

**SUMMARY**

MAWC does not agree with Staff’s proposed condition that MAWC “not be allowed recovery of the acquisition premium that will result from its purchase of Cedar Hill’s assets.” MAWC believes this condition is premature as MAWC is not seeking recovery or any other treatment of acquisition premium in this case. Accordingly, MAWC believes that this application can be distinguished from *State ex rel. Ag Processing, Inc. v. Public Service Commission*, 120 S.W.3d 732 (Mo. 2003) or, in the alternative, that the Commission can make the finding identified by the court in *Ag Processing* without allowing or disallowing recovery of acquisition premium at this point in time.

Additionally, MAWC seeks a modification to confirm that Staff’s proposed condition relating to rate base does not preclude adjustment of the rate base in a future rate case. MAWC also provides a comment concerning Staff’s proposed condition related to MAWC’s next rate case.

## **DISCUSSION**

1. On January 5, 2004, MAWC and Cedar Hill Utility Company, Inc. ("Cedar Hill") filed a Joint Application seeking authority for MAWC to purchase the Cedar Hill sewer system. On May 5, the Staff of the Commission filed a recommendation advising the Commission to approve that application but recommending that the Commission impose certain conditions on its approval. By Order dated May 10, 2004, the Commission directed that the Joint Applicants, no later than May 17, 2004, file a response to the Staff Recommendation.

2. Attached to the Staff Recommendation was a Memorandum. The Staff indicated in the Memorandum that it believed that the proposed acquisition should comply with certain conditions in order for the acquisition to not be detrimental to the public interest. The following conditions suggested by the Staff are applicable to MAWC:

- A. MAWC must record on its books and records an amount of CIAC equal to the balance in Cedar Hill's escrow account related to Northwest's contribution for the expansion of the Sand Creek wastewater treatment plant, when MAWC completes the plant expansion;
- B. MAWC must record the rate base value calculated by the Staff, as detailed on Attachment 1, on its books and records and use this rate base amount as the starting point for all future capital additions;
- C. Cedar Hill's customers must not experience a change in their current billing arrangement other than the fact that the name appearing on the bill will change to MAWC. Additionally, MAWC must continue billing Cedar Hill's customers under the provisions of Cedar Hill's current Commission approved tariff until MAWC's next general rate case is resolved;

D. MAWC must include the Cedar Hill system as part of its next general rate case filing; and,

E. MAWC must not be allowed recovery of the acquisition premium that will result from its purchase of Cedar Hill's assets.

3. MAWC objects to Condition "E," which states that "MAWC must not be allowed recovery of the acquisition premium that will result from its purchase of Cedar Hill's assets." Additionally, MAWC seeks clarification as to Condition "B" relating to rate base. MAWC also will provide a comment herein concerning Staff's proposed Condition "D" related to MAWC's next rate case.

#### **CONDITION E - ACQUISITION PREMIUM**

4. MAWC believes that the Commission need not address acquisition premium at this time because MAWC has not requested recovery of acquisition premium, nor any other finding as to acquisition premium, in the application in this case.

5. The issue of denial of acquisition premium in a similar situation was previously heard by this Commission when MAWC acquired United Water Missouri Inc. (*In the Matter of the Joint Application of Missouri-American Water Company and United Water Missouri, Inc.*, Report and Order, Case No. WM-2000-222, 2000 Mo. PSC LEXIS 304, 9 Mo. P.S.C. 3d 56 (March 16, 2000)). In that case, the Staff similarly sought to deny recovery of acquisition premium at the time of acquisition, in spite of the fact that the acquiring company (MAWC) had not asked the Commission to address recovery. The Commission found as follows:

The matter of the acquisition adjustment is also not properly before the Commission in this case. That is a matter for a rate case, as the Applicants point out. This is not a rate case. Therefore, the Commission will not address the matter of the acquisition premium in this case. *See In the Matter of the Application of Missouri-American*

*Water Company for Approval of its Acquisition of the Common Stock of Missouri Cities Water Company*, Case No. WM- 93- 255 (*Report and Order*, issued July 30, 1993) at 8 and 10.

The only purported public detriment that any party has identified is the possibility of a future attempt to recover the acquisition premium from ratepayers. The Commission reads *State ex rel. City of St. Louis v. Public Service Commission*, *supra*, 335 Mo. at 459, 73 S.W.2d at 400, to require a direct and present public detriment. The acquisition premium, which MAWC may seek to recover from ratepayers in a rate case yet to be filed, is not a present detriment. "The Commission is unwilling to deny private, investor-owned companies an important incident of the ownership of property unless there is compelling evidence on the record tending to show that a public detriment will occur." *In the Matter of the Joint Application of Missouri Gas Company et al.*, Case No. GM-94-252, *supra*, 3 Mo. P.S.C. 3rd at 221. There is no such compelling evidence in this record.

6. The Commission is, of course, very aware of a more recent Missouri Supreme Court case that also addressed acquisition premium. In *State ex rel. Ag Processing, Inc. v. Public Service Commission*, 120 S.W.3d 732 (Mo. 2003), the Supreme Court found that the Commission failure to consider the acquiring company's (Aquila) proposed plan to recoup acquisition premium required reversal of the Commission's approval.

7. A clear distinction between the *Ag Processing* case and the case at hand is that in *Ag Processing*, Aquila (then UtiliCorp) proposed a regulatory plan as a part of the application that addressed recovery of the acquisition premium associated with the merger. No such proposal has been made in this case. Thus, the Commission's answer to the Staff's proposed condition here should be the same as in the United Water acquisition – i.e. a statement that the possible recovery of acquisition premium is an appropriate issue for a future rate case.

8. Even if the Commission believes that *Ag Processing* cannot be distinguished, *Ag Processing* does not require the Commission to rule as to "recovery" of acquisition premium. The Missouri Supreme Court stated that "[w]hile [the Commission] may be unable to speculate about

future merger-related rate increases, it can determine whether the acquisition premium was reasonable, and it should have considered it as part of the cost analysis when evaluating whether the proposed merger would be detrimental to the public.” *Ag Processing* at p. 736. In a footnote to this sentence, the Supreme Court defined this “cost analysis” by citing in a footnote *State ex rel. Martigney Creek Sewer Co. v. Public Service Commission*, 537 S.W.2d 388, 399 (Mo. banc 1976), which was said to state “that, for ratemaking purposes, recovery of the cost of an asset acquired from another utility depends on the reasonableness of the acquisition, considering the factors of whether the transaction was at arm’s length, if it resulted in operating efficiencies, and if it made possible a desirable integration of facilities.”

9. Using this standard, the Commission should be able to, and MAWC will stipulate, that the acquisition premium is “reasonable,” based upon the following factors:

- The transaction between MAWC and Cedar Hill is at arm’s length. The companies are not affiliates and the transaction was negotiated by independent company representatives and attorneys;
- The resulting transaction will result in operating efficiencies because responsibility for the billing, management, purchasing and other activities will be absorbed by MAWC’s existing operations; and,
- While the transaction will not result in the physical integration of facilities, as stated above, many other aspects of the operation will be integrated.

**CONDITION B - RATE BASE**

10. Condition B states that “MAWC must record the rate base value calculated by the Staff, as detailed on Attachment 1, on its books and records and use this rate base amount as the starting point for all future capital additions.” MAWC does not object to utilizing this amount for

purposes of its initial entries. However, MAWC believes that it should be allowed to adjust these entries, if new information becomes available to the Company and Staff. For example, if it is discovered that the value of certain assets have not been recorded, MAWC believes that it should be allowed the opportunity to present this information to the Commission in its next rate case.

11. Recently, in *In the Matter of the Joint Application of Missouri-American Water Company and Warren County Water & Sewer Company*, Case No. WM-2004-0122 (November 20, 2003), the Commission stated:

Determining the value of these assets for ratemaking treatment is a proper issue for Missouri-American's next rate case. By considering the value of the assets in the context of a rate case, the Commission can be assured of considering all the necessary factors in determining just and reasonable rates.

12. Similarly in this case, the Commission should not foreclose the possibility of considering evidence of the proper value of the assets for ratemaking purposes in MAWC's next rate case. To reach this result, MAWC would propose that Condition B be modified to add the following language:

However, MAWC may present evidence in its next rate case as to the value of these assets for ratemaking treatment.

#### **CONDITION D - NEXT RATE CASE**

13. Staff's Condition D states that "MAWC must include the Cedar Hill system as part of its next general rate case filing."

14. MAWC is unsure what this condition has to do with whether the proposed transaction is "not detrimental to the public interest." Presumably, the rates resulting from MAWC's next rate case could be either less or greater than the current rates paid by Cedar Hill's customers. It is

therefore unclear at this point in time what impact a rate case will have on the Cedar Hill customers. MAWC would encourage the Commission to determine that this condition is not relevant to the question at hand. However, should the Commission determine that the condition is relevant, MAWC will agree to the condition.

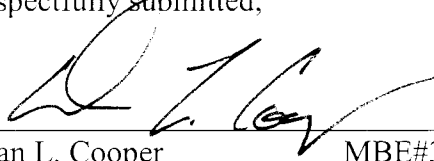
### **CONCLUSION**

15. As stated previously, MAWC is not asking the Commission to address acquisition premium in this case. MAWC is comfortable to leave this issue for a future rate case. To the extent that the Commission believes it has a requirement to address acquisition premium, MAWC believes this duty is merely to “determine whether the acquisition premium was reasonable.” Given the standard provided by the Supreme Court for this determination, MAWC believes the acquisition premium is “reasonable,” and would be willing to stipulation to such a finding.

16. MAWC further believes that a modification to the Staff’s condition relating to rate base is necessary to provide for the possibility that new evidence will become available as to the appropriate value of Cedar Hill’s assets. Lastly, MAWC believes that the Staff’s condition related to MAWC’s next rate case is not relevant to the Commission’s inquiry. However, MAWC will agree to this condition, if the Commission takes a position to the contrary.

WHEREFORE, MAWC respectfully requests that the Commission consider this response to the Staff Recommendation.

Respectfully submitted,



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ATTORNEYS FOR  
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### CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail, on May 17<sup>th</sup>, 2004, to the following:

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