

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

In the Matter of the Application of)	
Confluence Rivers Utility Operating Company, Inc.,)	
For Authority to Acquire Certain Water and Sewer)	File No. WA-2019-0299
Assets and for a Certificate of Convenience and)	
Necessity)	

**LAKE PERRY LOT OWNERS ASSOCIATION
INITIAL BRIEF**

INTRODUCTION

In this the second round of briefs, the Lake Perry Lot Owners Association (“Association”) will present its argument for why this transaction is detrimental to the public interest. The Association intends to show that the Missouri Public Service Commission (“Commission”) has created a Gordian Knot, a Gordian Knot which is distorting the Commission’s view of these cases. This Gordian Knot is based on a misinterpretation and a misapplication of the law stated in *State ex rel. Mo. Pac. Freight Transport Co. v. Public Service Commission* (“*Freight Transport*”). Contrary to the Commission’s interpretation and application, *Freight Transport* stands for the proposition that, “the **rights of an applicant**, with respect to the issuance of a certificate of convenience and necessity, are considered **subservient** to the public interest and convenience.”¹ The Commission has wrongly applied *Freight Transport* to make the interests and rights of certain individuals and groups subservient to whatever the Commission deems in the public interest. The Association asks the Commission to cut this Gordian Knot.

¹ *Missouri Pac. Freight Transport Co. v. Public Service Commission*, 295 S.W.2d 128, 132 (Mo. 1956). [emphasis added]

SUMMARY OF ARGUMENT

The Association shall in this Initial Brief make the following points:

- The Commission’s interpretation and application of *Missouri Pac. Freight Transport Co. v. Public Service Commission* is flawed. It has no authority to make the rights of individuals or groups subservient to the Commission’s declaration of public interest.
- The Commission must make the regulated rights of the applicant subservient to the rights of the public and require the applicant to prove that the application is not detrimental to the public interest by showing the public is no worse off after the transaction than it was before.
- Confluence Rivers has affirmatively avoided proving that the transaction is not detrimental to the public interest and, therefore, has failed to carry its burden of proof.
- The Association has shown that the transaction will place the Lake Perry community and the state in a worse situation than they are in now without the transaction. Therefore, the transaction is detrimental to the public interest.
- The Commission should exercise its function as the surrogate of competition and direct Confluence Rivers to take the option of terminating its Agreement.

LIST OF ISSUES

1. What is the net book value of the Port Perry Service Company’s (“Port Perry”) water and wastewater assets?

“[T]he net book value for the Port Perry assets as of December 31, 2019, is \$20,070 for water and \$57,866 for sewer. The net book value amounts for both water and sewer assets will be used as the starting amounts for the calculation of rate base (with regard to the Port Perry assets) in Confluence River’s next rate case.”² So reads the *Stipulation and Agreement as to Net Book Value* (“*Stipulation*”) filed with the Commission by Confluence Rivers Utility Operating Company, Inc. (“Confluence Rivers”), the Staff of the Missouri Public Service Commission (“Staff”), and the Office of the Public Counsel (“OPC”). The Lake Perry Lot Owners Association agrees with the statement in the *Stipulation*. The Commission should make a finding consistent with the above quoted statement in the *Stipulation*.

² *Stipulation and Agreement as to Net Book Value*, p. 2

2. Given the answer to the first question, should the Commission find that Confluence Rivers Utility Operating Company, Inc.'s ("Confluence Rivers") acquisition of the Port Perry Service Company's ("Port Perry") water and wastewater assets and certificates of convenience and necessity is not detrimental to the public interest, and approve the transaction? No.

Legal Standard

The Commission is a creature of statute. "As a creature of statute, the Commission's powers are limited to those conferred by statute, either expressly, or by clear implication, as necessary to carry out the powers specifically granted."³ [citation omitted] In this case, the Commission must find that the Applicant has shown that the transaction will not be detrimental to the public interest.⁴ According to the Missouri Supreme Court in *Ag Processing v. Public Service Commission*, 120 S.W.3d 732, 736 (Mo. 2003), the Commission must "consider and decide all the necessary and essential issues" and on balance determine the transaction is not detrimental to the public interest. What is required is a **cost-benefit analysis** in which all the benefits and detriments in evidence are considered. And the Commission must not only consider the proposed transaction but all opportunity costs.⁵

Additionally, the Association must apprise the Commission of a mistake that continues to occur in these cases. The mistake involves the Commission's misinterpretation and

³ *Missouri Public Service Commission v. Oneok, Inc.*, No. WD 70666 (Mo. App. 12/8/2009) (Mo. App. 2009).

⁴ *State ex rel. City of St. Louis v. Public Service Commission of Missouri*, 73 S.W.2d 393, 400 (Mo. banc 1934). *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo. App. 1980).

⁵ *In the Matter of the Application of Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P for Authority to Transfer Operational Control of Certain Transmission Assets to the Midwest Independent Transmission System Operator, Inc.*, Case No. EO-2008-0046 (October 9, 2008), pp. 16, 17.

misapplication of *State ex rel. Mo. Pac. Freight Transport Co. v. Public Service Commission*, 288 S.W.2d 679, 682 (Mo. App. 1956).

In its recent *Report and Order* in the Osage Utility Operating Company case, File No. WA-2019-0185, the Commission rendered the following Conclusion of Law:

The public interest is a matter of policy to be determined by the Commission. It is within the discretion of the Public Service Commission to determine when the evidence indicates the public interest would be served. . . . In making such a determination, the total interests of the public served must be assessed. This means that some of the public may suffer adverse consequences for the total public interest. **Individual rights are subservient to the rights of the public.** The "public interest" necessarily must include the interests of both the ratepaying public and the investing public; however, **as noted, the rights of individual groups are subservient to the rights of the public in general.**⁶

[emphasis added] The Commission has repeatedly used this policy statement to claim for itself the right to declare the “public interest,” a public interest it has the sole discretion to declare. But nothing could be further from the design of the Public Service Commission Law. The Commission has no authority to make individual rights subservient to the rights of the public. Such a proposition is antithetical to the very founding of this great republic and of the state of Missouri.⁷

However, a simple reading of the *Freight Transport* cases will suffice to reveal the Commission’s error. *Freight Transport* was an appeal from an order of the Commission denying

⁶ In the Matter of the Application of Osage Utility Operating Company, Inc., File Nos. WA-2019-0185 and SA-2019-0186. Report and Order (April 8, 2020), p. 26, quoting *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc.*, Report and Order, Case No. EM-2007-0374, 2008 Mo. PSC LEXIS 693, 458-459 (MoPSC July 1, 2008); which in turn cited *State ex rel. Mo. Pac. Freight Transport Co. v. Public Service Commission*, 288 S.W.2d 679, 682 (Mo. App. 1956).

⁷ Article I, Section 2 of the Missouri Constitution declares, “That all constitutional government is intended to promote the general welfare of the people; that all persons have a natural right to life, liberty, the pursuit of happiness and the enjoyment of the gains of their own industry; that all persons are created equal and are entitled to equal rights and opportunity under the law; that to give security to these things is the principal office of government, and that when government does not confer this security, it fails in its chief design.”

a request to expand a transportation company's authority to operate motor carriers over certain routes. There was some question regarding whether that authority could have been granted initially. However, when the application came before the Commission to expand the authority, the Commission denied the application as being detrimental to the public interest because adequate service was already being provided and additional service would produce destructive competition for the consuming public.

In upholding the denial of the application, the Court stated,

The rights of an **individual with respect to issuance of a certificate** are subservient to the rights of the public. [citation omitted] The dominant purpose in creation of the Commission is public welfare. [State ex rel. and to use of Alton R. Co. v. Public Service Commission, Mo.App., 110 S.W.2d 1121, 1125.](#) The administration of its authority should be directed to that purpose. In every case where it is called upon to grant a permit, or to authorize an additional service to be rendered by an authorized certificate holder, the Commission should be guided, primarily, by considerations of public interest. Consequently, the question of public convenience and necessity was of prime importance in this case. [emphasis added]

Freight Transport, 288 S.W.2d 679, 682 (Mo. App. 1956). In this, it is clear that the subservient rights are the rights of the regulated entity, not the individual God-given rights of the private citizens. See also, The Declaration of Independence, para. 2 (U.S. 1776).

The Missouri Supreme Court affirmed this proposition as well. Upon transfer to the Supreme Court, that Court stated, "In the determination of these matters, the **rights of an applicant**, with respect to the issuance of a certificate of convenience and necessity, are considered **subservient** to the public interest and convenience." [emphasis added] *See Missouri Pac. Freight Transport Co. v. Public Service Commission*, 295 S.W.2d 128, 132 (Mo. 1956).

What these cases tell the Commission is that it is not free to pick and choose those entities and interests it "deems" to be in the public interest. It must protect the "public interest" against the subservient interests of the regulated applicant. The applicant must prove that there is

no detriment to the **public** interest. In other words, the consuming public must be in no worse position and at no greater risk than it was prior to the transaction. The Commission's role is prophylactic in nature. The Commission may not deem the applicant's interest to be the public interest and thereby impose a burden on the public.

One example of how the Commission may not pick and choose its special public interests was highlighted during the Commission's open agenda meeting of February 13, 2020. At that meeting, Commissioner Rupp voiced support for granting Central States' application to purchase the Osage Water Company assets and then explained:

I don't want to be sending a message to other companies that are looking at distressed systems saying "Hey, come on out here and bid and if we don't like you and we can find a public entity then we are just going to hand it to them." I don't think it is detrimental to the public interest.

Commissioner Rupp's policy statement has no connection to a determination of the public interest in this case. It is an elevation of the applicant's subservient interest over the primary interest of the consuming public.

ARGUMENT

Confluence Rivers must prove that its transaction is not detrimental to the public interest. Confluence Rivers must prove that its transaction will place the Lake Perry community and the state of Missouri in no worse position than they are now. They cannot carry their burden of proof by saying "trust me" or "that is what we do."

Confluence Rivers has failed to carry their burden of proof. As specifically related to the issue before the Commission at this juncture—the net book value—Confluence Rivers has done everything in its power to avoid making that showing. Confluence Rivers' conduct since the Commission reopened this proceeding has been consistent with its conduct in this entire proceeding. It has obfuscated and prevaricated. When the Commission reopened this

proceeding on the public interest aspects of the net book value, Confluence Rivers sought to have the hearing truncated in its *Response to Proposed Procedural Schedule*, filed on March 23, 2020. It failed to file direct testimony or even rebuttal testimony describing the public interest benefit of its transaction considering the Staff's findings on net book value. It moved to strike the Association's rebuttal testimony discussing the negative public interest impact of the transaction considering the Staff's findings on net book value. Finally, and only when the Chairman asked a question about why Confluence Rivers still wanted to go forward with the transaction did Confluence Rivers provide any answer. Why the obfuscation? What is Confluence Rivers trying to hide?

Confluence Rivers did finally give an answer in response to a question from the Chairman at the hearing. In response to the Chairman's question, Mr. Cox responded:

Chairman Silvey, there are two reasons why we still want to do consummate this transaction. One is that Port Perry, is, you know, the typical type of system that we specialize in. They are under 500 individual connections. And really our company, our mission vision, is to bring safe and reliable water resources to every committee in the US. And small communities, particularly those under 500, they really represent the communities that are most at risk for a lack of safe and reliable service.

* * * * *

The second reason is we -- if you think about from a total company perspective, the delta between the net book value and the forward purchase price is, you know, 0.24 percent of our current investment in property plant and equipment. you know, from a Confluence Rivers standpoint it's 3.9 percent of our total investment of property, plant, and equipment.⁸

The first is a rather overblown marketing declaration. The second is deceptive if not completely wrong. Confluence Rivers also gave some new questionable information on redirect examination after the Chairman's question in the form of Exhibit No. 601C. The Association will critique that information below.

⁸ Transcript - Volume 7 (Evidentiary Hearing - Jefferson City, MO via WebEx Conference - May 19, 2020), pp. 379, 380.

The Commission must analyze these claims and desires of Confluence Rivers critically. It must consider the second claim most critically. Mr. Cox claims the acquisition premium is 3.9 percent of the total investment of property, plant, and equipment of Confluence Rivers. Mr. Cox's claim is deceptive if not completely wrong. The acquisition premium is ** percent of the company's net plant in service.⁹ Adding in the net book value of Port Perry only reduces that proportion to **** percent.¹⁰ Net plant in service, i.e. net book value, is the amount of investment Confluence Rivers is authorized to earn a return on. Confluence Rivers is not allowed to recover a return on its total investment of property, plant, and equipment. Mr. Cox's statement is inconsequential except to show the magnitude of its extravagant investment history. Mr. Cox's claim more supports the concern Mr. Justis raises in his Rebuttal Testimony that there are legitimate concerns regarding Confluence Rivers' recovery of its extravagant investments.

The Commission must place the other data from Exhibit 601C and consider it in the context of the above. First, the Commission must ignore the Missouri American transaction with Hallsville, Missouri, inasmuch as it is not an executed transaction, which has not been filed with the Commission or approved by the Commission.¹¹ Second, the Missouri American transaction with Lawson, Missouri has a zero dollar acquisition premium since the net book value equals the purchase price.¹² Third, the net book value of the Wardsville water and sewer assets exceeds the purchase price.¹³

⁹ Confluence Rivers' net book value from its Annual Report for January 1 – December 31, 2019, as filed with the Commission on May 5, 2020, is \$561,518. See page 4. (acquisition premium/(nbv of water and sewer assets)) = (*****/(315,332+246,186)) = ****.

¹⁰ (*****/(315,332+246,186+77,936)) = ****.

¹¹ See *Status Report and Motion for Late-Filed Exhibit file by Office of Public Counsel*, May 27, 2020, ¶ 5.

¹² See *Status Report and Motion for Late-Filed Exhibit filed by the Office of Public Counsel*, May 27, 2020, ¶ 6.

¹³ See *Status Report and Motion for Late-Filed Exhibit filed by the Office of Public Counsel*, May 27, 2020, ¶ 8.

Fourth, the Commission must consider the financial and business conditions of the two entities Missouri American and Confluence Rivers. Missouri American has a Net Plant in Service more than 2 billion dollars and a net income in excess of 60 million dollars. Confluence Rivers has a Net Plant in Service of \$561,518 and a net income of **negative** \$530,035.¹⁴ There are no similarities between the transactions or the organizations. Missouri American, a well-established, financially stable company, is prudently investing money that it has at a price comparable to the net book value of the assets. Confluence Rivers, a thinly financed, under recovering entity, is imprudently throwing money at a transaction it does not have based on an inflated desire, to “bring safe and reliable water resources to every committee¹⁵ in the US,” based on their “mission vision.” There is simply no evidence supporting the proposition that Confluence Rivers has the financial capability or business wisdom to carry through with this transaction without harming the public interest.

Compare the undisputed evidence of Association witness Glen Justis. Mr. Justis observes that the excessive acquisition premium will force Confluence Rivers into a situation where it will have to over-recover on the net book value to obtain a reasonable return on its investment. See Rebuttal Testimony of Glen Justis, p. 3. He conclusively observes that there are five main scenarios for such a recovery, all of which should be concerns for the Commission:

1. Confluence uses excessive leverage (debt) to drive up the return on invested equity. Using the above example, Confluence would need a leverage level of approximately 66% debt to achieve a 14% return on invested equity.
2. Confluence drives down operating expenses to unsustainable levels, thereby jeopardizing service quality and system maintenance.

¹⁴ See *Annual Report of Confluence Rivers Utility Operating Company*, January 1 – December 31, 2019, pp. W-1 and S-1.

¹⁵ As in ¹⁵ Transcript - Volume 7 (Evidentiary Hearing - Jefferson City, MO via WebEx Conference - May 19, 2020), pp. 379, 380. The Association assumes Mr. Cox said or intended to say “community.”

3. Confluence engages in self-dealing to create hidden gains to compensate its investors for the excessive acquisition premium.
4. Confluence pursues unnecessary and/or gold-plated capital projects at Lake Perry using alternative forms of financing that are obscured from the Commission, and then attempts to obtain a return on these investments in later rate cases at a distorted (inaccurately high) claimed cost of capital.
5. Confluence attempts to socialize the acquisition premium across both Lake Perry and other service areas, unfairly driving up rates for other customers.

See Rebuttal Testimony of Glen Justis, p. 4. These options are more concerning considering Confluence Rivers already has a negative net income.

Mr. Justis' conclusions are bolstered by the testimony of Mr. DeWilde. As a CPA and business planner, Mr. DeWilde observed that the acquisition premium is ****% of Port Perry's net book value and on the high end of an acquisition premium for an attractive free-market business but is not appropriate for Port Perry.¹⁶ He observed that this unrecoverable acquisition premium will put a financial strain on Confluence Rivers.¹⁷ Even Confluence Rivers' own witness did not want to under-recover on this transaction.¹⁸ The fact that Confluence Rivers is still seeking to consummate this transaction is confusing considering the provisions they placed in the agreement itself for this very eventuality.¹⁹

Mr. DeWilde also observed that if the Commission determines to regulatorily protect such transactions, they will foreclose more reasonable transactions.²⁰ And he confirmed Mr. Justis' observation that it will be difficult to make this transaction work considering the makeup of the Lake Perry community.²¹

¹⁶ Exhibit No. 701, p. 4.

¹⁷ Exhibit No. 701, pp 6-7.

¹⁸ Exhibit No. 701, p. 5.

¹⁹ Id.

²⁰ Exhibit No. 701, p. 6.

²¹ Exhibit No. 701, p. 7.

The Commission must be realistic. The unrecoverable acquisition premium in this case alone is approximately *** of the potential Net Plant in Service of Confluence Rivers. This is an untenable situation, especially when Confluence Rivers' Net Income for 2019 was a **negative** \$530,035.

The Commission cannot simply state that the acquisition premium is not recoverable and conclude the ramifications will work themselves out in the next rate case. Again, the Commission must be realistic. When Confluence Rivers' next rate case comes before the Commission, Confluence Rivers and the Commission will have to figure out some way to make the rates cover this transaction that the Commission approves in this case. The Commission will have to deal with Mr. Justis' five inappropriate alternatives or let Confluence Rivers go bankrupt.

Is this transaction detrimental to the public interest? Most certainly, yes. Any outcome will be worse for the community of Lake Perry. Consider what the Lake Perry community has now. Lake Perry has stable, environmentally compliant water and sewer systems that provide safe and adequate service to the community at a reasonable rate. The community does not want Confluence Rivers' service and can take over the service and provide Port Perry a reasonable offer for the assets should Port Perry's services begin to deteriorate.

What will the public in the Lake Perry community receive if the Commission approves this transaction? They get a distant company that has significantly over-paid for the assets it will be operating. They will receive a small water and sewer service supplier that is making a negative net income that has consistently expended money it arguably cannot recover. And they have a Commission that, although with good intentions, states that it approved the transaction to incentivize such companies to continue this conduct, all the while assuring the consuming public that the ramifications will be addressed in the next rate case. They get a situation in which the

Commission will have to at some point figure out how to allow Mr. Justis' five scenarios to come to fruition or allow Confluence Rivers to default on its service. All the while, these regulatory protections of Confluence Rivers will foreclose reasonable offers from coming before this Commission. This is detrimental to the public interest.

Quite frankly, Confluence Rivers has invited the Commission to deny this Application.

Paragraph 4 of the *Agreement for Sale of Utility System* provides in part, “*****

*****” The Commission should take Confluence Rivers up on its suggestion and deny the Application, recognizing the prudent option would be to terminate the agreement.”

CONCLUSION

The role of the Commission is to take the place of competition. It must determine whether the transaction is detrimental to the **public** interest. It may not determine whether the transaction is beneficial to the Commission's own institutional best interest. This case presents a transaction that will cause the public in the Lake Perry community and the state of Missouri to be worse off than they are now. The proper response for the Commission is to fulfill its role as the surrogate for competition, determine that this is a fool hardy and profligate transaction, conclude this transaction would not work in a free market, and determine the transaction is detrimental to the public interest. It must deny the Application.

WHEREFORE, the Association respectfully requests the Commission deny the Application.

Respectfully submitted,



By: _____

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing was sent to all parties of record in File No. WA-2019-0299 via electronic transmission this 2nd day of June 2020.

