

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

In the Matter of the Joint Application of)
West 16th Street Sewer Company, W.P.C.)
Sewer Company, Village Water and Sewer)
Company, Inc. and Raccoon Creek Utility)
Operating Company, Inc., for Raccoon Creek)
to Acquire Certain Sewer Assets and,)
In Connection Therewith, Issue Indebtedness)
and Encumber Those Assets)

File No. SM-2015-0014

**RECOMMENDATION TO CONDITIONALLY APPROVE THE TRANSFER OF
ASSETS, AND ISSUANCE OF A CERTIFICATE OF CONVENIENCE AND
NECESSITY**

COMES NOW Staff of the Missouri Public Service Commission, by and through the undersigned counsel, and files this Recommendation to Conditionally Approve the Transfer of Assets, and Issuance of a Certificate of Convenience and Necessity, respectfully requesting the Commission conditionally approve the transfer of assets as requested, with the conditions as described in Staff's Memorandum and as specifically recommended herein below. In support of this Recommendation, Staff states as follows:

1. On July 14, Applicants, West 16th Street Sewer Company, ("West 16th"), W.P.C. Sewer Company, ("WPC"), Village Water and Sewer Company, Inc., ("Village") and Raccoon Creek Utility Operating Company, Inc., ("Raccoon Creek") filed their *Joint Application and, If Necessary, Motion for Waiver*. Applicants requested that the Commission approve Raccoon Creek's agreements to purchase West 16th, WPC, and Village's sewer assets. Raccoon Creek would partially finance the purchase via debt that would encumber those assets, and also asks the Commission to approve the same. Finally, Raccoon Creek wishes to become regulated by the Commission, and, thus, also

wishes for the Commission to grant it a certificate of convenience and necessity to own and operate those sewer assets.

2. The details of Staff's investigation of this Application are stated in Staff's Memorandum, attached as *Appendix A*.

3. Staff takes the position that the transfer of assets from the Sellers to Raccoon Creek is in the public interest, assuming Staff's recommended conditions are imposed, because the Sellers no longer wish to be in the utility business, and because Raccoon Creek has adequate technical, managerial, and financial capacity to operate, maintain, and improve the facilities and service to customers.

4. Staff recommends that the Commission issue an order that:

- a. Approves the sale of sewer assets, under conditions as described within this memorandum and following;
- b. Immediately grants Raccoon Creek a CCN to provide water and sewer service in the existing service areas of West 16th, WPC and Village, to be exercised upon closing of the respective assets;
- c. Prohibits Raccoon Creek from closing on assets or operating as a sewer utility unless it has operation, billing, and emergency answering arrangements (contracts) that can be in place applicable to the specific service area and exercised immediately upon closing of assets;
- d. Requires Raccoon Creek to notify the Commission of closing of each of the individual Sellers' assets within five (5) days after such closing;

e. Authorizes Sellers to cease providing service immediately after closing of the respective assets, then after closing and notifications of such as contemplated in d., above, separately for each of the individual utilities, cancel the CCNs currently issued to West 16th, WPC and Village, respectively, for sewer service;

f. If closing of any of the Sellers' assets does not take place within thirty (30) days following the effective date of the Commission's order, requires Raccoon Creek to submit a status report within five (5) days after this thirty (30) day period regarding the status of closing on the specific assets, and additional status reports within five (5) days after each additional thirty (30) day period, until closing takes place, or until Raccoon Creek determines that a sale of the specific assets will not occur;

g. If Raccoon Creek determines that a sale of any of the assets will not occur, requires Raccoon Creek to notify the Commission of such, after which time the Commission may cancel, or deem null and void, the CCN issued to Raccoon Creek for the specific service area;

h. Authorizes Raccoon Creek to operate using each of the Seller's existing tariffs, on an interim basis, immediately after closing of the respective assets but before the effective date of such tariff adoption notice sheets;

i. Requires Raccoon Creek to file tariff adoption notice sheets for each of the Seller's sewer tariffs within thirty (30) days after closing of the respective assets, to adopt existing rules, rates and service charges;

- j. Authorizes Raccoon Creek to utilize depreciation rates that are currently approved for each of the Sellers, as shown in Attachments D, E and F;
- k. Requires Raccoon Creek to keep its financial books and records for plant-in-service and operating expenses in accordance with the NARUC Uniform System of Accounts;
- l. Requires Raccoon Creek to keep operations records identifiable for each of its systems, including those for customer complaints/inquiries, vehicle mileage, equipment and telephone use records, and customer account records;
- m. Requires Raccoon Creek to maintain time sheets for all employees and officers, including Josiah Cox, to document time spent on Raccoon Creek matters. Raccoon Creek shall also maintain mileage logs to document transportation expense associated with Raccoon Creek business. Time sheets and mileage logs should specifically identify time and mileage by individual system, the amount of time spent on construction projects and time spent on other activities such as non-regulated activities, including acquisition and/or merger activities, etc.
- n. Requires Raccoon Creek to track outside contractor expense (for customer billing, customer calls, plant operator, etc.) for each of Raccoon Creek's systems, and any other Central States Water Resources, Inc. and entities it owns, in a manner that would allow identification of costs that were incurred for Raccoon Creek business only. Raccoon Creek will track

contractor expenses such as mileage, equipment, labor telephone and other office expenses that are specific to Raccoon Creek only.

o. Requires either each of the Sellers individually, or Raccoon Creek, as the parties may be able to agree upon, to pay the annual assessments that are past due or due through Fiscal Year 2015, in the total amount of \$2,385.81;

p. Requires Raccoon Creek to comply with all Commission Rules including the filing of the annual reports and keeping current on payments of the Commission's annual assessments;

q. Makes no finding of the value of this transaction for rate making purposes, specifically as it relates to the ** ** interest rate assigned to the debt, but also to other elements, including, but not limited to, the capital structure; and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions, and their effect on cost of capital, in any later proceeding;

r. Authorizes Raccoon Creek to collateralize only up to \$690,000 of its assets to issue secured debt;

s. Requires Raccoon Creek to maintain certain minimum financial covenants. If the debt service coverage ratio should fall below 1.50 times or the Debt/EBITDA ratio exceeds 5.00 times, Raccoon Creek must cure the violation of these covenants by making additional equity contributions and/or reducing the amount of debt at no cost to the ratepayer;

t. Requires Raccoon Creek Utility Operating Company, Inc. ** [REDACTED] [REDACTED] [REDACTED] ** to provide Staff access, upon reasonable written notice during normal working hours, to all books and records related to investments in Missouri regulated utility assets. The access to information shall include, but not be limited to information provided to or received from the proposed debt investor, ** [REDACTED] **

u. In the event of default on the Raccoon Creek Utility Operating Company, Inc. loan, requires ** [REDACTED] ** to file a written plan with the Commission on how it will ensure continued funding necessary to maintain safe and adequate service for the Raccoon Creek Utility Operating Company, Inc. system customers; and,

v. Makes no finding that would preclude the Commission from considering the ratemaking treatment to be afforded any matters pertaining to the granting of the subject Certificate, including expenditures related to the certificated service area, in any later proceeding.

WHEREFORE, Staff files this *Recommendation to Conditionally Approve the Transfer of Assets, and Issuance of a Certificate of Convenience and Necessity* and requests the Commission conditionally approve the transfer of assets as requested, with the conditions as described in Staff's *Memorandum*.

Respectfully submitted,

/s/ Alexander Antal

Alexander Antal

Assistant Staff Counsel

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Missouri Public Service Commission

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been served to all counsel of record by hand delivery, electronic mail, or First Class United States mail this 30th day of September, 2014.

/s/ Alexander Antal

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. SM-2015-0014
West 16th Street Sewer Company
W.P.C. Sewer Company
Village Water and Sewer Company, Inc.
Transfer of Assets to Raccoon Creek Utility Operating Company, Inc.

FROM: Jim Merciel – Water and Sewer Unit; Case Coordinator
Aaron Archer – Water and Sewer Unit
Shana Atkinson – Financial Analysis Unit
John Robinett – Engineering and Management Services Unit
Bill Harris – Auditing Unit
Joel Molina – Auditing Unit
Matthew Young – Auditing Unit

<u>/s/ Jim Merciel</u>	<u>September 30, 2014</u>
Case Coordinator	Date

<u>/s/ Kevin Thompson</u>	<u>September 30, 2014</u>
Staff Counsel	Date

SUBJECT: Staff's Recommendation to Conditionally Approve the Transfer of Assets, and Issuance of a Certificate of Convenience and Necessity

DATE: September 30, 2014

CASE BACKGROUND

On July 14, 2014 West 16th Street Sewer Company (West 16th), W.P.C. Sewer Company (WPC), Village Water and Sewer Company, Inc. (Village), sometimes collectively referred to as "Sellers," along with Raccoon Creek Utility Operating Company, Inc. (Raccoon Creek), filed a *Joint Application and if Necessary Motion for Waiver* (Application) with the Commission. The Sellers and Raccoon Creek are requesting authorization for Sellers to sell and transfer sewer utility assets to Raccoon Creek. Along with the transfer of assets, it will be necessary to grant a Certificate of Convenience and Necessity (CCN) to Raccoon Creek, and cancel the CCNs currently held by West 16th, WPC, and Village. Additionally, in the Application Raccoon Creek is requesting Commission

Appendix A

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Authority to allow it to collateralize the systems' assets for purposes of raising up to \$1,600,000 in funds through a term loan.

On July 21, 2014 the Commission issued its Order and Notice and Order Directing Filing (Order) regarding the Company's Application. The Order directed the Commission's Data Center and Public Information Office to send out their public notices regarding the Application, and also established a deadline of 21 days from the date of the Order, August 11, 2014, for interested parties to submit requests to intervene in the case. No requests to intervene in the case were submitted to the Commission. The Order also established August 11, 2014 as the date by which Staff should file a pleading stating when it anticipates filing a recommendation. On August 11, 2014 Staff filed its *Status Report*, wherein it noted the interconnection of this case with another case, WO-2014-0340 filed by Hillcrest Utility Operating Company, Inc. which shares common corporate officers with Raccoon Creek, and also stated that a recommendation could be filed by September 10, 2014. On August 13, 2014 the Commission issued its Order Directing Filing, in which the Commission requires Staff to file its recommendation by September 10, 2014. On September 10, 2014 Staff requested an extension of time to file its Recommendation to September 30, 2014, and then on September 11, 2014 the Commission granted the request for extension of time.

BACKGROUND OF THE UTILITY SYSTEMS

West 16th provides service to 149 residential customers in the Hunters Ridge subdivision near Sedalia in Pettis County. It obtained a CCN in Case No. SA-90-288. The sewer system consists of gravity collecting sewers, one lift station, and a 55,000 gallons per day (gpd) extended aeration treatment facility. West 16th's DNR permit expires on December 31, 2014. At present there are no major DNR compliance issues although there have reportedly been occasional sewage overflows, and it is expected that ammonia limits will be included with the next re-issued DNR permit.

WPC provides service to 68 residential customers in the South Walnut Hills subdivision, also near Sedalia. The sewer system was originally owned by a previous regulated sewer utility, South Walnut Hills Sewer Corporation, which obtained a CCN in Case No. 18,704 in 1976. South Walnut Hills Sewer Corporation sold the sewer utility assets to WPC with Commission approval in Case No. SM-89-45. The sewer system consists of gravity sewers and a 22,950 gpd extended aeration treatment facility. Its DNR permit expires on December 31, 2015, and this current permit requires that the treatment facility will have to meet new limits for ammonia by July 31, 2017. Part D of WPC's DNR permit outlines a schedule of compliance pertaining to submitting progress reports to DNR, regarding meeting the July 31, 2017 permit limits.

Village provides service to 241 single-family and multi-family residential customers in the Villages at Whiteman subdivision, near Knob Noster, MO in Johnson County. It obtained a CCN to provide both water and sewer service in Case No. WA-90-47. Village sold its water system assets, with Commission approval in Case No. WM-96-454, to Public Water Supply District No. 3 of Johnson County and has continued to operate as a sewer utility only since that time. The sewer system consists of gravity sewers and a 100,000 gpd 3 cell aerated lagoon with chlorine disinfection. Its

DNR permit expires on June 30, 2016, and requires compliance with new ammonia limits by February 1, 2016.

STAFF'S INVESTIGATION

In its investigation of this case, Staff studied the rate base levels of West 16th, WPC, and Village, and the apparent abilities of Raccoon Creek. Staff is evaluating Raccoon Creek by applying principles of Technical, Managerial, and Financial Capacities, similar to methodologies used by the United State Environmental Protection Agency and DNR to evaluate new water systems. Although the president of Raccoon Creek has experience with water and sewer systems, Raccoon Creek and its president both are newcomers with respect to privately-owned regulated utilities

Technical Capacity

Raccoon Creek's president has experience in the design and operation of water and sewer systems. Raccoon Creek intends to utilize one or more contract operators for plant operations, utilizing the services of appropriately qualified and licensed utility system operators, ultimately supervised by the president of Raccoon Creek. The contract operators will undertake routine day-to-day inspections, checks, sampling and reporting for the sewer systems, as well as accomplish most system repairs and extraordinary operations tasks as the need arises, to address proper facility operations and customer service matters. Raccoon Creek will not have an operations contract executed for any of the Sellers until after approval of the transfer of assets and the parties are ready to close on the transfers, and thus Staff will recommend that Raccoon Creek not close on the assets of any of the Sellers' assets until applicable operations contracts can be in place immediately after closing.

Raccoon Creek will be contemplating upgraded or replacement sewage treatment facilities in coming years to meet more stringent environmental regulations. Raccoon Creek outlines possible improvements in the Application, and states preliminary estimated capital costs for the West 16th system to be \$421,000, for the WPC system to be \$416,500, and for the Village system to be \$535,500. Raccoon Creek also estimates that future sewer rates for its customers, after the treatment facility improvements are completed to be \$94.50 per residential customer. Staff takes no position in this case regarding specific plant improvements and future rates. Rather, the prudence and actual costs of such improvements will be studied and become issues in a future rate case.

Financial Capacity

The Auditing Unit conducted a review of plant-in-service records as of June 30, 2014 in order to determine the net book value of the assets, and to determine whether acquisition premiums exist as a result of the proposed acquisitions by Raccoon Creek. Staff reviewed documentation relating to the amount of rate base in each of the three sewer systems identified as part of these acquisitions including annual reports, previous rate case and complaint case stipulations and exhibit modelling systems (EMS) runs from prior rate and complaint cases. Though only one asset acquisition case has been filed with the Commission, Staff has valued the rate bases for each of these systems,

independent from one another, on an individual, stand-alone basis. Attachments A, B and C, incorporated herein by reference, respectively show West 16th's, WPC's and Village's, plant-in-service, depreciation reserve, CIAC and CIAC amortization balances as of June 30, 2014. Current rate base levels are \$31,467 for West 16th, \$29,082 for WPC and \$126,973 for Village, for a total rate base level related to the systems proposed to be acquired by Raccoon Creek of \$187,522.¹

The rate base levels for West 16th and WPC compare to the most recent Commission-ordered rate base levels as follows:

Sewer Utility	Rate Base at June 30, 2014 – Case No. SM-2015-0014	Rate Base at December 31, 2012 – Case No. SC-2013-0332 (West 16th) and Case No. SR-2013-0053 (WPC)
West 16th	\$31,467	\$35,144
WPC	\$29,082	\$31,698

During its investigation, Staff examined Raccoon Creek's valuation of WPC and West 16th assets and found two significant miscalculations that may affect the purchase price of the companies. First, while valuing the ultraviolet (UV) disinfection system that has been installed at WPC's treatment facility, Raccoon Creek included the cost of the environmental upgrades for 2012 and 2013. However, all UV construction was completed in 2012 and was already included in the rate base agreed to by WPC and Staff in Case No. SR-2013-0053.

Second, Raccoon Creek obtained the 2012 Annual Reports filed with the Commission to determine the values of each of the rate base items for West 16th. Raccoon Creek appears to have based its purchase price of West 16th on a rate base that was different than the amount found appropriate in Case SC-2013-0332. The rate base totals found in the annual report had not been adjusted to the agreed-upon rate base in the Unanimous Stipulation and Agreement ordered by the Commission in Case No. SC-2013-0332. After Staff issued a deficiency report, West 16th amended the 2012 Annual Report. Raccoon Creek apparently used the original report and not the corrected annual report to base its purchase price offer.

In regard to the matter of whether acquisition premiums exist as a result of the proposed acquisitions, the purchase prices being paid by Raccoon Creek for West 16th, ** _____ **, and for WPC, ** _____ **, are greater than the net book values of the sewer assets being acquired and greater than the rate base amounts identified by Staff. The purchase price Raccoon Creek is paying for Village, ** _____ ** is less than the net book value of the sewer assets that are being acquired and less than the rate base amount identified by Staff. Thus, acquisition premiums do exist for West 16th and WPC but an acquisition premium does not exist for Village. The total purchase price for the Sellers' systems, ** _____ **, results in no acquisition premium for all of the systems combined.

¹ The rate base numbers shown for these systems simply reflect Staff's findings in its review of this case, and are presented for information only. There has been no negotiation with other parties who might be interested in current rate base levels and who might believe different numbers are appropriate. The Staff is not recommending that the Commission make any finding on rate base level, nor make any rate adjustments, in this case.

West 16th Rate Base

Staff updated West 16th's rate base through June 30, 2014 based on the rate base established by the Unanimous Stipulation and Agreement in SC-2013-0332. It is Staff's understanding that West 16th may need to add a disinfection system after its DNR permit is renewed (current permit expiration is December 17, 2014) in order to comply with revised DNR water quality rules. The expected disinfection system addition is not reflected in the West 16th rate base determined in this case. As such, Staff will evaluate the amount of rate base in subsequent cases to determine the appropriate amount of rate base to be included in such future rate cases.

The amount of rate base determined in the last examination of West 16th rates in Case No. SC-2013-0332 was \$35,144 as of December 31, 2012. The rate base determined in this sale case for West 16th as of June 14, 2014 is \$31,467. Compared to the purchase price of ** _____ **, the Purchase Price proposed to be paid for this sewer system is substantially higher than the current rate base determined in this case. The Purchase Agreement between the seller and buyer dated April 23, 2014 identified the purchase price but also contained a condition that states ** _____

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WPC Rate Base

Staff updated WPC's rate base through June 30, 2014 based on the rate base established by the Disposition Agreement in SR-2013-0053. The agreed-upon rate base was established by WPC's installation of a UV system in order to meet DNR requirements. Prior to the addition of the UV system, WPC had no rate base because all of its plant in service was contributed. Staff assumes the purchase price being paid by Raccoon Creek considered this significant investment by WPC. Staff will evaluate the amount of rate base in subsequent cases to determine the appropriate amount of rate base to be included in future rate cases.

The amount of rate base determined in the last examination of WPC rates in Case No. SR-2013-0053 was \$31,698 as of December 31, 2012. The rate base determined in this sale case for WPC as of June 14, 2014 is \$29,082. Compared to the purchase price of ** _____ **, the Purchase Price proposed to be paid for this sewer system is substantially higher than the current rate base determined in this case. The Purchase Agreement between the seller and buyer dated April 23, 2014 identified the purchase price but also contained a condition that states ** _____

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Village Rate Base

Since Staff's rate base for Village significantly exceeds the price Raccoon Creek is paying for the Village assets, Staff assumes that much of the rate base will be in need of upgrade or retirement and replacement by the new owner should the Commission approve this acquisition. As such Staff will

evaluate the amount of rate base in subsequent cases to determine the appropriate amount of rate base to be included in future rate cases.

Proposed Planned Plant Additions

Raccoon Creek has indicated it will make substantial improvements to existing plant for all three of these sewer systems. The application identifies the plant additions expected to be made to all three systems as:

<u>Company</u>	<u>Plant Additions</u>	<u>Source</u>
West 16 th	\$421,000	[paragraph 11 of Application]
WPC	\$416,500	[paragraph 12 of Application]
Villages	\$535,500	[paragraph 13 of Application]

To identify an approximate estimate of the rate base after the proposed plant additions are made, Staff developed a rate base which included a plant adjustment for the additions referenced in the Application. Attachments G, H and I included with this recommendation each are two EMS runs for the three sewer systems, to compare rate base levels and revenue requirements for existing plant as of June 30, 2014 and what rate bases and revenue requirements would be assuming the plant additions are made. It should be noted the information regarding these plant additions did not identify the amounts of existing plant expected to be retired. As a consequence, the rate base amounts after additions may be overstated.

Summary of Rate Base Levels for the Three Sewer Systems

Staff examined the rate base as indicated above by examining prior rate cases, annual reports and other information over the years that each system has been in existence. The amount of rate base for all three sewer systems is based on the period ending June 30, 2014.

Summary of Purchase Price compared to rate base:

Company	Purchase Price- HC	Rate Base at June 30, 2014 without additions	Plant Additions per Application	Rate Base at June 30, 2014 with additions
West 16 th	** _____ **	\$31,467	\$421,000	\$452,467
WPC	** _____ **	\$29,082	\$416,500	\$445,582
Village	** _____ **	\$126,973	\$535,500	\$662,473

Sources for Purchase Prices: “AGREEMENT FOR SALE OF SEWER SYSTEM,” dated April 23, 2014 for West 16th (Appendix E-HC, page 3 paragraph 4), dated April 23, 2014 for WPC (Appendix F-HC, page 3 paragraph 4), and dated June 12, 2014 for Village Water & Sewer Company (Appendix G-HC, page 3 paragraph 4).

As previously stated, planned additions do not reflect any retirements that may occur, which will affect rate base, and as such these future rate base levels as estimated by Staff may be overstated for future ratemaking.

Requirements for Raccoon Creek

By Commission regulations, Raccoon Creek should keep its financial records for utility plant-in-service and operating expenses in accordance with the National Association of Regulatory Utility Commission (NARUC) Uniform System of Accounts. Staff will recommend the Commission specifically require such recordkeeping. Raccoon Creek will also be required to file annual reports with the Commission, and pay annual assessments to the Commission.

The Engineering and Management Services Unit (EMSU) had performed a complete review of the sewer utility assets' depreciation rates, plant-in-service, and the accumulated depreciation reserves for Sellers in SC-2013-0332 (West 16th), SR-2013-0053 (WPC) and SR-98-94 (Village). The depreciation rates ordered in those cases are still appropriate, and Staff recommends that Raccoon Creek adopt the current Commission-ordered depreciation rates of each of the Sellers for the respective sewer utility assets acquired in this case. The depreciation accrual rates for sewer assets are included as Attachments D, E and F for West 16th, WPC and Village, respectively, and incorporated herein by reference. The Audit Unit used these depreciation rates in calculating the recommended rate bases discussed above. Further information regarding financial capacity, specifically Raccoon Creek's requested approval to enter into secured indebtedness, is discussed in this memorandum, below.

Managerial Capacity

Similar to routine facility operations, Raccoon Creek intends to utilize a contract billing agent, and utilize an emergency answering service. The billing agent will be responsible for computing, printing, and sending monthly bills to customers, and then collecting payment. The billing agent will also have customer service staff that will be able to take and process customer calls with inquiries pertaining to billing, make bill adjustments and enter into payment plans within company guidelines, interact with Staff in working with customer complaints, and manage new customer accounts and the closing of customer accounts. In conjunction with an answering service that may be a different agent, the contract billing agent will also be available to route service complaints and inquiries. The president of Raccoon Creek, Josiah Cox, will also be available by telephone at most all times when severe emergencies arise. Also similar to an operations contract as discussed above, Raccoon Creek will not have any specific billing and answering service contract in place until after the transfer is approved, and Staff will recommend that Raccoon Creek not close on the assets until such contracts can be in place immediately following closing.

Raccoon Creek will need to comply with the Commission's regulations with respect to customer billing and customer complaints/inquiries, certain aspects of utility system upkeep including placement of customer meters along with meter testing/replacement, and recordkeeping to document

company operations expenses including vehicle use, equipment use, and telephone use. Staff can assist with setting up appropriate record systems as necessary and desired.

CONDITIONAL APPROVAL OF INDEBTEDNESS

Background

Raccoon Creek is ** _____

_____ **.

During Staff's investigation, Staff learned that ** _____

_____ ** Hillcrest Utility Operating Company, Inc. (Hillcrest), has a pending file, Case No. WO-2014-0340, seeking authority to acquire and encumber the assets of Brandco Investments LLC, a regulated water and sewer utility. Raccoon Creek's proposed financing arrangement in this case is based on the same terms from the same lender, ** _____
_____ **, as proposed in the Hillcrest case. ** _____

_____ **.

Collateralization/Financing Request

Pursuant to Section 393.190, RSMo, Raccoon Creek is requesting Commission Authority to allow it to collateralize the system's assets for purposes of raising up to \$1,600,000 in funds through a loan from ** _____ ** ** _____ ** is not a traditional lender regulated by state or federal banking authorities. ** _____
_____ ** investors. ** _____

_____. The term of the loan is ** __ ** years and according to recent communications with Raccoon Creek, it would be an amortizing loan issued at a ** ____ ** interest rate. Raccoon Creek would use the funds primarily for the construction of new activated sludge mechanical wastewater treatment plants, to meet MDNR regulatory compliance. Raccoon Creek plans to initiate this construction almost immediately after it acquires the systems from West 16th, WPC and Village. The loan will result in a lien on substantially all of the properties acquired by Raccoon Creek and to be built by Raccoon Creek, including its Certificates of Convenience and Necessity. Therefore, the loan will be secured by a lien or encumbrance on Raccoon Creek's utility



franchises, plant and system that are used to provide service to its customers, and also an encumbrance against any additional plant and assets. Raccoon Creek stated in its application that the cost estimates to make the needed improvements to all of the systems totaled \$1,373,000 (\$421,000 for West 16th; \$416,500 for WPC; and \$535,000 for Village). According to Raccoon Creek's pro forma financial statements, Raccoon Creek is targeting a capital structure of 80% debt and 20% equity. Considering the total projected project costs, if Raccoon Creek were capitalized with 80% debt, this would amount to a debt amount of \$1,098,400 (.80 x 1,373,000). Therefore, Staff is unsure of the reason Raccoon Creek is asking for approval to collateralize the systems' assets for purposes of raising an amount of debt that would cause its capital structure to contain more than 100% debt.

Under the current proposed financing arrangement, ** ____ ** would not have to contribute any funding as an equity investment. This simply does not make sense considering the Company had communicated to Staff in the past that it had planned to contribute approximately 20% equity to each of its planned investments. Under either scenario, Raccoon Creek is proposing an extreme amount of leverage, especially for a business proposal in which the investor relies on an assumption that it can charge the ratepayers near \$100 a month for sewer service. The Applicant has made several assumptions about how this new plant would be treated in future ratemaking proceedings after these significant investments are made. Consequently, the ability of Raccoon Creek to service this debt is highly dependent on the regulatory ratemaking process. Raccoon Creek's president, Josiah Cox, communicated to Staff that he understood that certain of his ratemaking assumptions would not be considered approved for ratemaking if Staff recommended approval of the acquisition. Initially, in the Hillcrest acquisition case, Mr. Cox had communicated to Staff that he believed if the Commission authorized the Applicant's request to issue secured debt at a rate of ** ____ **, this would constitute as Commission approval of the cost of this debt for purposes of determining the allowed rate of return in future rate cases. Staff had communicated to Josiah Cox that even if it recommended approval of the request to collateralize the assets in order to issue the requested debt, , Staff would explicitly condition its recommendation on not endorsing the ** ____ ** rate for purpose of setting rates. Staff's position is based on its concerns about whether this is a true market rate considering unique circumstances surrounding the proposed investment structure, as well as apparent affiliations between the proposed debt investor and two of the equity investors. Although Mr. Cox had communicated to Staff in the Hillcrest case that he needed the Commission to authorize the 14% cost of debt in order for the proposed investments to be successful, based on his now formal response in that case provided in his direct testimony, it appears he no longer holds that position.

Staff estimated potential rates based on its own ratemaking assumptions, specifically using a hypothetical cost of debt and a return on equity based on a risk premium allowed over that debt. Based on Staff's assumed rates, Staff cannot support a collateralization request and issuance in excess of \$690,000, assuming the terms represented in the term sheet provided in the application of ** ____ ** interest rate and a ** ____ **-year amortization are the best terms Raccoon Creek can negotiate.

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Staff's recommendation to limit the amount of the debt issuance is based on applying a return on equity of 11.26% and a cost of debt of 7.26% to a capital structure consisting of 80 percent debt and 20 percent equity. The cost of debt is based on the most recent 3 month average yield of 10 and 30 year bonds with a B rating. The cost of equity is determined by simply adding a 4 percent risk premium to the assumed cost of debt.

Staff's main concern in regard to the financing is whether or not Raccoon Creek will have enough cash flow to be able to meet its annual interest and principal payments on the debt. The debt service coverage ratio is a good measure of a company's ability to service its debt and the Debt/Earnings Before Interest, Taxes, Depreciation and Amortization (Debt/EBITDA) ratio is a good measure of the amount of leverage the company's cash flows may be able to support. If the debt service coverage ratio equals 1.00, it would mean the company is generating just enough cash to pay its annual debt payment. Based on Staff's estimate of potential rates after the planned construction, Raccoon Creek's debt service coverage ratio would only be .647 times if they issued the requested \$1,600,000. This ratio illustrates that the Company would not be able to generate enough cash to pay its annual debt service payment if it issues \$1,600,000. The financial covenants in the loan documents provided in response to a Staff Data Request explain that Raccoon Creek shall not permit the ** _____ **. This ** _____ ** is the same as the ** _____ **.

_____. Raccoon Creek would be in violation of the ** _____ ** even without assuming any downside scenario. Based on Staff's estimations, the Company could only borrow approximately \$865,000 in order to possibly have enough cash flow to meet the financial covenant in its loan documents. Staff does not believe it is prudent to authorize the collateralization of the utility properties by ** _____ **, an unknown entity with unknown intentions, if it appears Raccoon Creek will not be able to meet its debt service requirements under more conservative ratemaking assumptions. Staff would feel more comfortable if the Company's estimated debt service coverage ratios were at least 1.50, which is more typical of minimums required by more conservative debt investors. Staff estimates that the Company can borrow \$690,000 at an interest rate of ** ____ ** with a ** __ **-year amortization for Raccoon Creek's debt service coverage ratio to equal at least 1.50 times.

The Debt/EBITDA ratio is used by credit rating agencies, such as Standard & Poor's (S&P), to assess the probability of default. The higher a company's Debt/EBITDA ratio, the greater a company's financial risk is in regards to making its debt payments. S&P's financial benchmarks list a Debt/EBITDA of greater than 5 times as a "Highly Leveraged" financial risk in its matrix for its "Standard" volatility table. "Highly Leveraged" is the highest financial risk category of the financial risk profiles in S&P's Business and Financial Risk Profile Matrix. Based on Raccoon Creek's current proposed debt amount of \$1,600,000, its Debt/EBITDA would be 10.37 times if Staff's more conservative rate case assumptions are used. This is an extremely high amount of leverage which cannot be sustained. If Raccoon Creek issued \$690,000, its Debt/EBITDA would be approximately 4.47 times.

Not only does Staff propose that Raccoon Creek only be allowed to collateralize up to \$690,000 of its assets to issue secured debt, but Staff also believes Raccoon Creek's equity investors should be required to maintain certain minimum financial ratios. If the debt service coverage ratio should fall below 1.50 times or the Debt/EBITDA ratio exceeds 5.00 times, the Company must make equity contributions and/or reduce the debt level to cure the violation of the minimum ratio requirements.

Staff also conditions its recommendation specifically on not endorsing the ** ____ ** cost of debt rate as being appropriate for purposes of future ratemaking. Staff will recommend a debt cost it believes is appropriate at the time in which Raccoon Creek files a rate case. Staff and the Company can debate the appropriate rate of return to allow in context of the rate case.

OTHER ISSUES

Raccoon Creek is not currently a regulated utility, and thus it does not yet have any annual report or assessment payment responsibilities. All of the Sellers are current on their annual reports through calendar year 2013. All of the Sellers owe annual assessment payments, as follows:

West 16th Street Sewer Company

\$460.14 total for FY2015 one quarterly payment \$115.04 is past due as of July 15, 2014
\$696.11 past due for FY2014

W.P.C. Sewer Company

\$276.84 total for FY2015 one quarterly payment \$69.21 is past due as of July 15, 2014
\$302.49 past due for FY2014

Village Water and Sewer Co., Inc.

\$650.23 total for FY2015 one quarterly payment \$162.56 is past due as of July 15, 2014

\$998.60 total past due for FY2014

\$1387.21 total assessment amount due for FY2015

\$346.81 total past due quarterly payments for FY2015

\$1040.40 remaining for FY2015 that is not past due as of the date of this memorandum

\$2,385.81 total amount including past due, and due through FY2015

Staff recommends that either each of the Sellers be required to pay their assessment amounts from sale proceeds, or Raccoon Creek pay the assessments and deduct the amounts from the sale amounts payable to each of the Sellers.

As noted in the CASE BACKGROUND and CONDITIONAL APPROVAL OF INDEBTEDNESS sections of this memorandum, Hillcrest, an affiliate of Raccoon Creek, filed an Application on May

13, 2014, seeking authority to acquire and encumber the assets of Brandco Investments LLC, Case No. WO-2014-0340. Staff filed a recommendation in that case on August 26, 2014, in which it stated that approval of that case pertaining to Hillcrest, and conditions the Commission might apply to Hillcrest, could impact Staff's evaluation and possible recommended conditions for this current case filed by Raccoon Creek. Since this Raccoon Creek case and the Hillcrest case are similar, and involve common owners and corporation officers, actions undertaken by the Commission on either one of the cases, and conditions the Commission may impose in either one of the cases, could impact the other case.

CERTIFICATE OF CONVENIENCE AND NECESSITY

In the Application, Raccoon Creek requests the Commission grant it a CCN to operate as a sewer utility, and Staff agrees Raccoon Creek should be granted such a CCN in the context of this case, assuming there is agreement to Staff's proposed conditions. Further, Raccoon Creek will need to hold a CCN when it closes and acquires the assets of any of the Sellers and actually begins providing service to customers. Similarly, each of the Sellers, separately, should be relieved of their respective obligations to provide service upon closing and transferring the respective assets. However, due to inherent scheduling uncertainties, it is impractical for Staff and the Commission to try to work in advance with any exact date and time of closing of assets with regard to CCNs in effect for Raccoon Creek and each of the Sellers. Therefore, Staff recommends that the Commission, if and when the proposed transfer is approved, immediately grant Raccoon Creek a CCN for the service areas of each of the Sellers, the exercise of which Raccoon Creek may begin upon acquisition of each of the Sellers' respective assets. Staff recommends that Raccoon Creek notify the Commission within five (5) business days after closing takes place for each of the individual three Sellers, after which time the Commission may cancel the CCN of each of the respective Sellers. If any such transfer does not take place within thirty (30) days after the effective date of a Commission order authorizing the transfer and granting Raccoon Creek a CCN, then Raccoon Creek should submit a status report within five (5) days following that period of time regarding the proposed transfer, as well as further status reports within five (5) days of each thirty (30) day period following that as necessary. In the event that Raccoon Creek determines that the transfer of assets for any of the Sellers will not take place at all, then Raccoon Creek shall notify the Commission of such, at which time the CCN issued to Raccoon Creek for the service area of the respective Seller should be either canceled or deemed null and void by the Commission.

Staff recommends that Raccoon Creek adopt the sewer tariffs that are presently approved and on file for each of the sellers, by submitting adoption notice tariff sheets within thirty (30) days of closing of the respective Seller's assets. Staff also recommends that the Commission authorize Raccoon Creek to utilize and operate under the Sellers' tariffs in each of the respective service areas on an interim measure immediately after closing but before the respective adoption notice tariff sheets take effect.

STAFF'S FINDINGS & CONCLUSIONS

Staff takes the position that the transfer of assets from the Sellers to Raccoon Creek is in the public interest, assuming Staff's recommended conditions are imposed, because the owners of the Sellers no longer wish to be in the utility business, and because Raccoon Creek has adequate technical, managerial, and financial capacity to operate, maintain, and improve the facilities and service to customers. Staff recommends the Commission conditionally approve the transfer of assets as requested, with the conditions as described herein and as specifically recommended herein below.

STAFF'S RECOMMENDATIONS

Based upon the above, the Staff recommends that the Commission issue an order that:

- a. Approves the sale of sewer assets, under conditions as described within this memorandum and following;
- b. Immediately grants Raccoon Creek a CCN to provide water and sewer service in the existing service areas of West 16th, WPC and Village, to be exercised upon closing of the respective assets;
- c. Prohibits Raccoon Creek from closing on assets or operating as a sewer utility unless it has operation, billing, and emergency answering arrangements (contracts) that can be in place applicable to the specific service area and exercised immediately upon closing of assets;
- d. Requires Raccoon Creek to notify the Commission of closing of each of the individual Sellers' assets within five (5) days after such closing;
- e. Authorizes Sellers to cease providing service immediately after closing of the respective assets, then after closing and notifications of such as contemplated in d., above, separately for each of the individual utilities, cancel the CCNs currently issued to West 16th, WPC and Village, respectively, for sewer service;
- f. If closing of any of the Sellers' assets does not take place within thirty (30) days following the effective date of the Commission's order, requires Raccoon Creek to submit a status report within five (5) days after this thirty (30) day period regarding the status of closing on the specific assets, and additional status reports within five (5) days after each additional thirty (30) day period, until closing takes place, or until Raccoon Creek determines that a sale of the specific assets will not occur;
- g. If Raccoon Creek determines that a sale of any of the assets will not occur, requires Raccoon Creek to notify the Commission of such, after which time the Commission may cancel, or deem null and void, the CCN issued to Raccoon Creek for the specific service area;

- h. Authorizes Raccoon Creek to operate using each of the Seller's existing tariffs, on an interim basis, immediately after closing of the respective assets but before the effective date of such tariff adoption notice sheets;
- i. Requires Raccoon Creek to file tariff adoption notice sheets for each of the Seller's sewer tariffs within thirty (30) days after closing of the respective assets, to adopt existing rules, rates and service charges;
- j. Authorizes Raccoon Creek to utilize depreciation rates that are currently approved for each of the Sellers, as shown in Attachments D, E and F;
- k. Requires Raccoon Creek to keep its financial books and records for plant-in-service and operating expenses in accordance with the NARUC Uniform System of Accounts;
- l. Requires Raccoon Creek to keep operations records identifiable for each of its systems, including those for customer complaints/inquiries, vehicle mileage, equipment and telephone use records, and customer account records;
- m. Requires Raccoon Creek to maintain time sheets for all employees and officers, including Josiah Cox, to document time spent on Raccoon Creek matters. Raccoon Creek shall also maintain mileage logs to document transportation expense associated with Raccoon Creek business. Time sheets and mileage logs should specifically identify time and mileage by individual system, the amount of time spent on construction projects and time spent on other activities such as non-regulated activities, including acquisition and/or merger activities, etc.
- n. Requires Raccoon Creek to track outside contractor expense (for customer billing, customer calls, plant operator, etc.) for each of Raccoon Creek's systems, and any other Central States Water Resources, Inc. and entities it owns, in a manner that would allow identification of costs that were incurred for Raccoon Creek business only. Raccoon Creek will track contractor expenses such as mileage, equipment, labor telephone and other office expenses that are specific to Raccoon Creek only.
- o. Requires either each of the Sellers individually, or Raccoon Creek, as the parties may be able to agree upon, to pay the annual assessments that are past due or due through Fiscal Year 2015, in the total amount of \$2,385.81;
- p. Requires Raccoon Creek to comply with all Commission Rules including the filing of the annual reports and keeping current on payments of the Commission's annual assessments;

- q. Makes no finding of the value of this transaction for rate making purposes, specifically as it relates to the ** ____ ** interest rate assigned to the debt, but also to other elements, including, but not limited to, the capital structure; and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions, and their effect on cost of capital, in any later proceeding;
- r. Authorizes Raccoon Creek to collateralize only up to \$690,000 of its assets to issue secured debt;
- s. Requires Raccoon Creek to maintain certain minimum financial covenants. If the debt service coverage ratio should fall below 1.50 times or the Debt/EBITDA ratio exceeds 5.00 times, Raccoon Creek must cure the violation of these covenants by making additional equity contributions and/or reducing the amount of debt at no cost to the ratepayer;
- t. Requires Raccoon Creek Utility Operating Company, Inc. ** _____
_____ ** to provide Staff access, upon reasonable written notice during normal working hours, to all books and records related to investments in Missouri regulated utility assets. The access to information shall include, but not be limited to information provided to or received from the proposed debt investor, ** _____ **;
- u. In the event of default on the Raccoon Creek Utility Operating Company, Inc. loan, requires ** _____ ** to file a written plan with the Commission on how it will ensure continued funding necessary to maintain safe and adequate service for the Raccoon Creek Utility Operating Company, Inc. system customers; and,
- v. Makes no finding that would preclude the Commission from considering the ratemaking treatment to be afforded any matters pertaining to the granting of the subject Certificate, including expenditures related to the certificated service area, in any later proceeding.

Staff will file a further recommendation regarding approval of the tariff adoption notices that Raccoon Creek will be submitting in accordance with the Commission's order granting the CCN.

List of Attachments:

- Attachment A – Auditing Unit Plant-in-Service Balances - West 16th Street Sewer Company
- Attachment B – Auditing Unit Plant-in-Service Balances - W.P.C. Sewer Company
- Attachment C – Auditing Unit Plant-in-Service Balances - Village Water and Sewer Company, Inc.
- Attachment D – Depreciation Accrual Rates for Sewer Plant - West 16th Street Sewer Company
- Attachment E – Depreciation Accrual Rates for Sewer Plant - W.P.C. Sewer Company
- Attachment F – Depreciation Accrual Rates for Sewer Plant - Village Water and Sewer Company, Inc.
- Attachment G – Auditing EMS Run for Sewer Plant and Revenue - West 16th Street Sewer Company
- Attachment H – Auditing EMS Run for Sewer Plant and Revenue - W.P.C. Sewer Company
- Attachment I – Auditing EMS Run for Sewer Plant and Revenue - Village Water and Sewer Company, Inc.
- Attachment J – Rate Calculations and Bill Comparison - West 16th Street Sewer Company
- Attachment K – Rate Calculations and Bill Comparison - W.P.C. Sewer Company
- Attachment L – Rate Calculations and Bill Comparison - Village Water and Sewer Company, Inc.

SM-2015-0014

Affidavits

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

AFFIDAVIT OF AARON R. ARCHER

In the Matter of the Joint Application of)
West 16th Street Sewer Company, W.P.C.)
Sewer Company, Village Water and Sewer)
Company, Inc. and Raccoon Creek Utility)
Operating Company, Inc., for Raccoon Creek)
to Acquire Certain Sewer Assets and, In)
Connection Therewith, Issue Indebtedness)
and Encumber Those Assets)

File No. SM-2015-0014

STATE OF MISSOURI)
) SS
COUNTY OF COLE)


COMES NOW Aaron R. Archer, being of lawful age, and on his oath states the following: (1) that he is a Utility Policy Analyst in the Missouri Public Service Commission’s Water and Sewer Unit; (2) that he has knowledge and has reviewed Staff’s Recommendation to Conditionally Approve the Transfer of Assets, and Issuance of a Certificate of Convenience and Necessity for West 16th Street Sewer Company, W.P.C. Sewer Company, and Village Water and Sewer Company, Inc. and Raccoon Creek Utility Operating Company, Inc., for Raccoon Creek to Acquire Certain Sewer Assets and, In Connection Therewith, Issue Indebtedness and Encumber Those Assets; and he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



Aaron R. Archer
Utility Policy Analyst
Water & Sewer Unit

Subscribed and sworn to before me this 30 day of September, 2014.

LAURA BLOCH
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: June 21, 2015
Commission Number: 11203914



Notary Public

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

In the Matter of the Joint Application of West)
16th Street Sewer Company, W.P.C. Sewer)
Company, Village Water and Sewer) File No. SM-2015-0014
Company, Inc. and Raccoon Creek Utility)
Operating Company, Inc., for Raccoon Creek)
to Acquire Certain Sewer Assets and, In)
Connection Therewith, Issue Indebtedness)
and Encumber Those Assets)

AFFIDAVIT OF SHANA ATKINSON

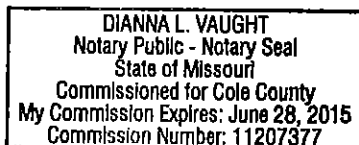
STATE OF MISSOURI)
) ss
COUNTY OF COLE)

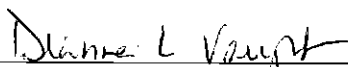
Shana Atkinson, of lawful age, on her oath states: (1) that she is a Utility Regulatory Auditor in the Missouri Public Service Commission's Regulatory Review, Utility Services Department, Financial Analysis Unit; (2) that she participated in the preparation of the foregoing *Staff's Recommendation for Approval of Transfer of Assets and Issuance of a Certificate of Convenience and Necessity (Staff Recommendation)*, in memorandum form; (3) that certain information in the *Staff Recommendation* was provided by her; (4) that she has knowledge of matters set forth in the *Staff Recommendation*; and (5) that such matters set forth in the *Staff Recommendation* are true and correct to the best of her knowledge, information and belief.



Shana Atkinson
Utility Regulatory Auditor
Financial Analysis Unit

Subscribed and sworn to before me this 30th day of September, 2014.





Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

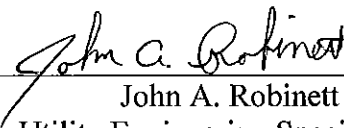
In the Matter of the Joint Application of)
West 16th Street Sewer Company, W.P.C.)
Sewer Company, Village Water and Sewer)
Company, Inc. and Raccoon Creek Utility)
Operating Company, Inc., for Raccoon Creek)
to Acquire Certain Sewer Assets and, In)
Connection Therewith, Issue Indebtedness)
and Encumber Those Assets)

File No. SM-2015-0014

AFFIDAVIT OF JOHN A.ROBINETT

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

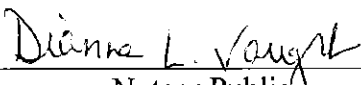
COMES NOW John A. Robinett, being of lawful age, and on his oath states the following: (1) that he is a Utility Engineering Specialist III in the Missouri Public Service Commission's Regulatory Review, Utility Services Department, Engineering & Management Services Unit; (2) that he participated in the preparation of the foregoing *Staff's Recommendation for Approval of Transfer of Assets and Issuance of a Certificate of Convenience and Necessity (Staff Recommendation)*, in memorandum form; (3) that he was responsible for the preparation of Attachments D, E and F to the Staff Recommendation; (4) that he has knowledge of the matters set forth in Attachments D, E and F to the Staff Recommendation; and (5) that the matters set forth Attachments D, E and F to the Staff Recommendation are true and correct to the best of his knowledge, information, and belief.



John A. Robinett
Utility Engineering Specialist III
Engineering & Management
Services Unit

Subscribed and sworn to before me this 30th day of September, 2014.

DIANNA L. VAUGHT
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: June 28, 2015
Commission Number: 11207377



Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI


In the Matter of the Joint Application of)
West 16th Street Sewer Company, W.P.C.)
Sewer Company, Village Water and Sewer)
Company, Inc. and Raccoon Creek Utility)
Operating Company, Inc., for Raccoon Creek)
to Acquire Certain Sewer Assets and, In)
Connection Therewith, Issue Indebtedness)
and Encumber Those Assets)

File No. SM-2015-0014

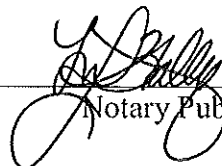
AFFIDAVIT OF MATTHEW R. YOUNG

STATE OF MISSOURI)
) ss.
COUNTY OF JACKSON)

COMES NOW Matthew R. Young, being of lawful age, and on his oath states the following: 1) that he is a Utility Regulatory Auditor in the Missouri Public Service Commission's Regulatory Review, Utility Services Department, Auditing Unit; (2) that he participated in the preparation of the foregoing *Staff's Recommendation for Approval of Transfer of Assets and Issuance of a Certificate of Convenience and Necessity (Staff Recommendation)*, in memorandum form; (3) that he was responsible for the preparation of Attachments A, B, C G, H and I to the Staff Recommendation; (4) that he has knowledge of the matters set forth in Attachments A, B, C G, H and I to the Staff Recommendation; and (5) that the matters set forth Attachments A, B, C G, H and I to the Staff Recommendation are true and correct to the best of his knowledge, information, and belief.


Matthew R. Young
Utility Regulatory Auditor
Auditing Unit

Subscribed and sworn to before me this 30th day of September, 2014.



Notary Public



MICHELE L. WATLEY
My Commission Expires
February 6, 2017
Jackson County
Commission #13445832