

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WA-2016-0019

FROM: Curt B. Gateley – Water & Sewer Department; Case Coordinator
Paul R. Harrison – Auditing Department
Deborah Bernsen – Consumer & Management Analysis Unit
Derick Miles, PE – Engineering Analysis Unit

/s/ Curt B. Gateley 10/2/2015
Water and Sewer Department / Date

/s/ Kevin Thompson 10/2/2015
Staff Counsel's Office / Date

SUBJECT: Staff's Recommendation to Approve Sale of Assets

DATE: October 2, 2015

CASE BACKGROUND

On July 28, 2015, Missouri-American Water Company (MAWC), and Hickory Hills Water & Sewer Company, Inc. (Hickory Hills), together referred to as "Applicants," filed a *Joint Application for Approval of Transfer of Assets* ("Application") seeking to sell and transfer the water system, sewer system, and associated assets including the existing Certificates of Convenience and Necessity (CCN), and associated tracts of land and buildings presently owned and/or operated by Hickory Hills to MAWC. On July 29, 2015, the Commission ordered a supplemental filing from the Applicants seeking a list of each county where an affected political subdivision is located. On August, 2015, MAWC filed a response to the Commission's Order that attested to all property owned by Hickory Hills being entirely included within, and affecting only, Moniteau County.

On August 5, 2015, the Commission issued its *Order and Notice* (Order) regarding the Application. The Order directed the Commission's Data Center and Public Information Office to send out notices regarding the Application to the clerk of Moniteau County. The Order also established a deadline of August 20, 2015, for interested parties to submit requests to intervene in the case, and for a Staff Recommendation to be filed by September 4, 2015. The Missouri Department of Natural Resources (DNR) submitted an application to intervene in this case on August 18, 2015. On August 6, 2015, MAWC filed a motion to consolidate the water and sewer cases, which the Commission granted on August 18, 2015, under which WA-2016-0019 became the primary case number. On August 31, 2015, Staff requested and was granted a motion for extension of its filing date to October 2, 2015, due to the time necessary to conduct audit activities for a transfer of assets case involving two regulated utilities.

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BACKGROUND OF THE WATER AND SEWER SYSTEMS AND UTILITY ENTITIES

Hickory Hills has CCNs that were issued by the Commission authorizing it to construct and provide service to the public through the sewer system in 1973 and the water system in 1975 (Case Nos. 17582 and 18205, respectively). Hickory Hills was abandoned by the previous owner and placed into receivership on January 2, 2007. Mr. Gary V. Cover of Clinton, MO is the court-appointed receiver and referred to herein as “Mr. Cover” or “Receiver.” On December 19, 2014, Hickory Hills, as a corporation, was administratively dissolved by the Secretary of State for failure to file a registration report, and this is the corporation status at present. On June 22, 2015 Hickory Hills submitted a *Motion for Authority to Execute Asset Purchase Agreement to Sell Assets of Hickory Hills Water & Sewer Co., Inc.* in the Cole County Circuit Court Case, which was sustained by an order issued by the court on July 10, 2015.

The water and sewer systems owned by Hickory Hills provide service to 48 residential customers in the Hickory Hills and Temple Terrace subdivisions in Moniteau County. Many of the customers are retired, and on fixed incomes.

The sewer system serving Hickory Hill’s service area is in noncompliance with DNR regulations and permit effluent limitations. The lagoon was constructed approximately 50 years ago, and is 30 years past its designed useful life. Since its construction, environmental and public health laws have changed, and the sewer collection system has deteriorated without significant rehabilitation activity. Lagoons in Missouri are designed with space for accumulated sludge, but the extra 30 years of accumulated sludge, which could have been removed but was not, has resulted in a reduction of available volume for effective treatment of wastewater. Sewer collection pipelines generally have a 50-year design life and may last even longer, but maintenance is necessary to repair breaks and deteriorating joints that allow entry of rainwater. At Hickory Hills during periods of significant precipitation, inflow and infiltration of rainwater can overload the collection system resulting in sewage back-ups into customer homes, overflows from manholes, and excessive flows into the lagoon. Excessive flows into the lagoon cause sludge to be washed out and sometimes wastewater to overflow the berms. Not only is a discharge of this nature illegal, it creates the risk of erosion of the lagoon berm which could result in the catastrophic failure of the lagoon itself. The ongoing violations lead DNR to file a lawsuit in December of 2012.

According to DNR, even when subject to normal flow, the single-cell lagoon is not technologically capable of compliance with the permit effluent limitations. Single-cell lagoons are not able to meet permit effluent limitations for Biochemical Oxygen Demand or Total Settleable Solids and DNR now requires lagoons to have no less than three cells. The facility is now also subject to water quality-based effluent limitations for ammonia and human health-based effluent limitations for bacteria. Lagoons are not designed to remove ammonia or bacteria and are typically not able to meet effluent limitations for these pollutants. The specific performance of Hickory Hill’s lagoon is not known at this time, because no monitoring reports have been submitted to DNR for at least the past three years.

Water is supplied via one well with a series of six 40-gallon pressure tanks to normalize water pressure and to serve as detention tanks for adequate chlorine disinfection contact time, along with approximately 6,700 feet of PVC distribution mains. Water produced is chlorinated for disinfection. All customers are metered. The sewer system is comprised of approximately 5,000 feet of gravity collecting sewer flowing to a single cell lagoon.

The water system is in fair condition, with adequate capacity and pressure, except that it does not meet one point of DNR's *Minimum Design Standards for Missouri Community Water Systems*, Publication 2489, commonly referred to as the "Design Guide" for water systems; that point being for single-well systems to have storage volume of one average day, in order to provide water to customers in the event of a pump failure, the replacement of which is a day-long task. However, similar to the sewer system, this water system pre-dates design points that are used today including the one-day storage recommendation in the Design Guide. The well house is in need of repair, including proper venting of chlorine gas. While on site responding to a failure of the chlorine feed pump, Staff was able to locate only two flush valves, and neither were operable.

The Receiver and Staff have been seeking to sell the assets of Hickory Hills and resolve the sewer system noncompliance in the intervening years. The closest municipal system, the City of California, has declined to extend utility services. No other water or sewer utilities are close enough to be available for connection. In the 2014 rate case (WR-2014-0167) Staff was asked by the Commission to put together a proposal for funding and constructing a new wastewater treatment facility to resolve the noncompliance. The most economical option was a small mechanical treatment plant, but this would have resulted in sewer bills of approximately \$120 per month. The rate shock resulting from a 300% increase in sewer bills caused a strong customer objection, and the substantial capital cost presented difficulty for the receiver. Hickory Hills withdrew the case with no proposal for resolution of the sewer system noncompliance. Customers remain highly motivated to see a resolution as the lack of a viable sewage system is not only detrimental to the environment; it is also a significant issue for property values, and efforts to obtain a home loan, because of the risk of the sewer system becoming inoperable.

MAWC is an existing Missouri Corporation in good standing, currently providing water service to more than 450,000 customers and sewer service to more than 14,000 customers in several districts across Missouri. MAWC has no overdue PSC annual reports or assessment fees, and there are no pending actions or final unsatisfied judgments or decisions against MAWC.

STAFF'S INVESTIGATION

The Receiver is charged with selling the corporation or liquidating its assets. The current sewer system does not provide customers safe and adequate service. The discharge of partially treated wastewater can impair public health, the environment, downstream landowners, and customer property values. The water system, while in fair condition, needs significant maintenance including a new well house. MAWC has the necessary financial resources and technical

expertise to resolve these issues. MAWC estimates repairs to the sewer collection system and construction of a wastewater treatment system to cost approximately \$700,000. A cost estimate has not been obtained for maintenance needs on the water system.

The purchase price for the Hickory Hills assets is stated at **_____** in the Application. In addition, MAWC states in its Application that it intends to utilize the current rates that Hickory Hills' has in place for its customers. The current rates for Hickory Hills' customers are \$20.47 per month with a usage charge of \$4.06 per thousand gallons for water service and a flat \$42.50 per month for sewer service. Staff will recommend that MAWC submit adoption notice tariff sheets as 30-day filings, but that it be authorized to operate under Hickory Hills' current tariffs until the adoption notice sheets become effective. These rates would be in effect until other rates are approved by the Commission in a future rate proceeding.

Because of limited cash flow for Hickory Hills, the Receiver has not been able to fully recover all of his court approved fees. Also, Mr. Cover personally took out a loan to pay off Hickory Hills' debt that the Receiver inherited from Hickory Hills' original owners and to compensate two customers for sewer backup claims against the Hickory Hills. Staff's understanding is that the purchase price for the Hickory Hill's assets in this transaction was agreed to in an amount allowing transfer of the assets at their current net book value, and also to allow Mr. Cover to recover a portion of his outstanding receivership costs (receiver fees and repayment of the personal loan). Staff participated in discussions with various entities, including MAWC and the Receiver, to find a solution to this situation. Staff generally supports receivers being reasonably compensated for their services whenever possible and concludes that the treatment of receiver fees in this application is appropriate.

Staff is proposing that the net book value as of August 31, 2015 be used to determine Hickory Hills' rate base in this case. Staff conducted an audit of Hickory Hills' plant in service, depreciation reserve, Contributions in Aid of Construction (CIAC), CIAC amortization and other rate base items in Cases Nos. WR-2014-0167 and SR-2014-0166. The net book value of Hickory Hills' assets as of August 31, 2015 was approximately \$8,902, all of which is attributed to the water system.

In Staff's view, the proposed payment made by MAWC to Hickory Hills that allows Mr. Cover reimbursement of a portion of his outstanding receivership fees and to pay off the personal loan was a reasonable and necessary investment by MAWC to enable transfer assets of a "troubled" utility under receivership to an experienced utility operator. Accordingly, under the specific facts and circumstances present in this case, Staff is recommending that MAWC establish a regulatory asset ("Deferred Receivership Costs") on its balance sheet in the approximate amount of **_____**, split equally between water and sewer, with those amounts to be amortized to expense over a five-year period. This amortization would begin the month after the Commission issues its order in this case. This regulatory asset represents the difference between the amount of the purchase price and the amount of Hickory Hills' net rate base, which will be used to satisfy a portion of the outstanding receivership fees owed and the outstanding loan.

For future rate considerations, and in order to effect the needed replacement and repairs to the

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systems, and recover the deferred receivership costs, without causing rates that could be considered excessive, MAWC proposes in the *Application* to consolidate Hickory Hills' customers in the St. Louis Metro District in the current rate case (WR-2015-0301), or in a future case. Staff supports this proposal.

MAWC has a staff of professionals that, along with staff associated with MAWC's affiliates, provides the ability to undertake facility operations, and handle all aspects of customer service. MAWC has, at most times over the years, demonstrated such ability with other service areas; however, Staff points out that recently MAWC has experienced some issues with certain aspects of services provided to its customers through affiliates. MAWC utilizes a nationwide billing system and nationwide call centers through affiliates. In order to incorporate Hickory Hills' customers into its billing and customer service systems, it will be necessary for MAWC, along with its affiliates, to properly enter Hickory Hills' customer account information into its billing system, to accurately apply appropriate Commission ordered rates, and to obtain and record correct meter readings. Also, it will be necessary for MAWC or an affiliate to provide updated information and training to the call center personnel regarding rates and rules applicable to Hickory Hill's customers such that customer service matters are handled accurately, properly and in a timely manner.

In previous CCN or transfer cases where MAWC acquired systems and additional customers, Staff either stipulated or recommended that MAWC undertake actions and submit reports to Staff that address a variety of customer service and billing issues. These actions and reports were stipulated or recommended in Case Nos. WM-2001-0309, WR-2003-0500, WR-2007-0216, WA-2015-0019 and SA-2015-0150. The Staff's subsequent review of these actions and reports will provide information to determine if MAWC's efforts to transition the new customers into their systems has been effective and resulted in the production of accurate bills.

In Case No. WC-2014-0138, a complaint was filed by the Office of the Public Counsel (OPC) against MAWC on November 13, 2013. This case was subsequently consolidated with 25 formal complaints filed by individual customers regarding similar customer service and billing issues in MAWC's Stonebridge service area. Staff completed a thorough investigation and filed a report on March 14, 2014, which included twenty (20) recommendations made to MAWC. The case resulted in a subsequent stipulation and agreement being filed between the OPC, MAWC and Staff and ordered by the Commission which indicated MAWC had sufficiently addressed the billing errors that had occurred.

Because of concerns identified during Staff's investigation in WC-2014-0138, Staff requested the opening of a docket to investigate the adequacy of the Call Centers serving MAWC. Staff's examination resulted in nine (9) recommendations for improvement in the MAWC's Call Center performance, which MAWC agreed to implement and the Commission ordered. Staff also requested the Commission order MAWC to comply with additional status reports and other requirements to permit Staff to effectively monitor MAWC's implementation of Staff's recommendations. The Commission included these monitoring requirements in its order.

The Engineering Analysis Unit had performed a complete review of the water and sewer utility assets' depreciation rates, plant-in-service, and the accumulated depreciation reserves for case numbers WR-2009-0151 and SR-2009-0154. The depreciation rates ordered in those cases are still appropriate, and Staff recommends that MAWC adopt the current Commission-ordered depreciation rates for the respective water and sewer utility assets acquired in this case.

The purchase of these systems by MAWC should not impact local tax collection, as the facility will remain in private hands.

STAFF'S FINDINGS AND CONCLUSIONS

Per 4 CSR 240-3.605 Staff is charged with evaluating whether an asset sale or transfer is "...not detrimental to the public interest." The Commission ordered its Staff to conduct an investigation into this matter and to provide the Commission with a recommendation. Staff concludes, based on its knowledge of the water and sewer systems and on information filed in the *Application*, that MAWC will be capable of operating and improving the systems and to provide safe and adequate service to the customers, which is not being provided at this time. Hickory Hills has not submitted an annual report for water or sewer for 2013 or 2014, as shown on the Commission's EFIS records. As posted by the Commission's Administration Division on its intranet site, Hickory Hills is delinquent in paying the FY2014 assessment amount of \$1,409.78 and the FY2015 assessment amount of \$434.07. Hickory Hills is also past due on submitting payment of the FY2016 assessment amount of \$297.84, which was due on July 15, 2015 with the option of quarterly payments on July 15, 2015, October 15, 2015, January 15, 2016 and April 15, 2016. Approval of the transfer of assets may have an impact upon the MAWC rate case pending before the Commission, as described above. MAWC will be committed to working with the Department of Natural Resources to bring the facility into compliance as soon as practicable.

Besides the current rate case mentioned above, MAWC has the following additional cases pending before the Commission.

- SA-2015-0065, MAWC's application for CCN, Benton County Sewer District
- WC-2015-0171, Formal complaint against MAWC by Michele Westmoreland
- WC-2015-0311, Formal complaint against MAWC by Charles Harter
- WC-2016-0057, Formal complaint by Tom Dillon
- WC-2016-0079, Formal complaint by Rhonda Martin

Except for possibly addressing this matter in the current rate case, this pending case will have no impact upon the other pending cases nor will the other pending cases impact approval of this proposed transfer of assets.

STAFF'S RECOMMENDATIONS

Based on the above reasons, Staff recommends that the Commission issue an order approving the transfer of assets. The Parties have satisfied the filing requirement of 4 CSR 240-3.605(1)(D), in that the Parties have shown that the sale of the assets is not detrimental to the public interest.

Staff recommends the Commission take the following actions:

1. Approve the proposed transfer of assets from Hickory Hills to MAWC.
2. Transfer the CCNs now held by Hickory Hills to MAWC, effective upon MAWC and Hickory Hills completing closing on the assets.
3. Order either MAWC or Hickory Hills to submit a statement that closing on the assets has occurred, within five (5) business days after closing has occurred.
4. Order MAWC to adopt the existing Hickory Hills water tariff, and sewer tariff, including existing rates, rules and service area, by filing tariff adopting notice sheets, as 30-day filings, within ten (10) days after closing on the assets; and further, that MAWC be authorized to operate under the Hickory Hills tariffs on an interim basis until the adoption notice tariff sheets become effective.
5. Order MAWC to adopt the current ordered Hickory Hills depreciation rates as ordered in case numbers WR-2009-0151 and SR-2009-0154.
6. Require MAWC to keep Hickory Hills' financial books and records for rate base, revenues and operating expenses in accordance with the NARUC Uniform System of Accounts;
7. Recognize the plant-in-service, depreciation reserve, CIAC and CIAC amortization balances, as calculated by the Audit Staff valued as of August 31, 2015, for purposes of rate base for plant-in-service and depreciation reserve to be included within the books and records of MAWC with respect to the Hickory Hills' system (the actual values for plant-in-service, depreciation reserve, CIAC and CIAC amortization are subject to review and adjustment in MAWC's next rate case); and requires MAWC to maintain and retain proper rate base records on a going forward basis;
8. Authorize MAWC to book a regulatory asset in the amount of approximately ** _____ **, split equally between water and sewer, associated with amounts paid related to for Hickory Hills' receivership fees and loan payoff. This regulatory asset is to be amortized over a five-year period, beginning the first month following the effective date of the Commission Order for this case.
9. Authorizes no recognition for accounting purposes of any "acquisition adjustment" or "acquisition premium" by MAWC associated with this purchase transaction in this case;
10. Order either MAWC or Hickory Hills to submit payment of the delinquent FY2014 and FY2015 assessments and payment of the FY2016 assessment of an amount to keep it current according to the option of quarterly payments within thirty (30) days after closing on the assets.
11. Require MAWC to ensure adherence to Commission Rule 4 CSR 240-13,020(1) regarding the production of customer bills with a 26-35 days of service billing period within thirty (30) days of the Commission order approving the Application;
12. Require MAWC to distribute to Hickory Hill's customers an informational brochure

detailing the rights and responsibilities of the utility and its customers prior to the first billing from MAWC, consistent with the requirements of Commission Rule 4 CSR 240-13(3);

13. Require MAWC to include the Hickory Hill's customers along with existing customers for its monthly reporting to the EMSU staff for 1) Average Abandoned Call Rate, 2) Average Speed of Answer, 3) 1st Call Effectiveness, 4) Average Customer Response Time, 5) Call Volumes, 6) Call Center Staffing Levels, including job titles and the number of people employed in each category, 7) the number of actual monthly meter reads in total and by district, 8) the number of monthly estimated meter reads, 9) the number of consecutive estimated reads and 10) the meter reader staffing levels;
14. Require MAWC to provide adequate training for the correct application of rates and rules to all customer service representatives prior to the Hickory Hill's customers receiving their first bill from MAWC;
15. Require MAWC to provide to the EMSU staff on a monthly basis a document detailing the bills to Hickory Hill's customers that were issued for greater than thirty-five (35) days of service;
16. Require MAWC to provide to the EMSU staff within thirty (30) days of billing a sample of ten (10) billing statements of the first three months bills issued to Hickory Hill's customers, in order to check for accuracy;
17. Require MAWC to provide an example of its communication with the Hickory Hill's customers regarding their acquisition of Hickory Hills and how they can be reached.
18. Order MAWC to work with DNR to resolve the sewer noncompliance as quickly as possible.
19. Make no finding that would preclude the Commission from considering the ratemaking treatment to be afforded any matters pertaining to the granting or transfer of the CCN to MAWC, 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 MAWC will be submitting in accordance with the Commission's order approving the transfer of assets.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of)
Hickory Hills Water & Sewer Co., Inc. and)
Missouri-American Water Company, for)
MAWC to Acquire Certain Water and)
Sewer Assets of Hickory Hills and, in)
Connection Therewith, Issue Indebtedness)
and Encumber Assets)

Case No. WA-2016-0019

AFFIDAVIT OF DEBORAH BERNSEN

State of Missouri)
) ss.
County of Cole)

AFFIDAVIT

COMES NOW Deborah Bernsen and on her oath declares that she is of sound mind and lawful age; that she contributed to the attached Staff Recommendation and that the same is true and correct according to her best knowledge and belief.

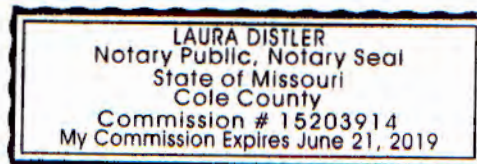
Further the Affiant sayeth not.


Deborah Bernsen

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 2nd day of October, 2015.


NOTARY PUBLIC



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

In the Matter of the Joint Application of)
 Hickory Hills Water & Sewer Co., Inc. and)
 Missouri-American Water Company, for)
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 Sewer Assets of Hickory Hills and, in)
 Connection Therewith, Issue Indebtedness)
 and Encumber Assets)

Case No. WA-2016-0019

AFFIDAVIT OF CURT B. GATELEY

State of Missouri)
) ss.
 County of Cole)

AFFIDAVIT

COMES NOW Curt B. Gateley and on his oath declares that he is of sound mind and lawful age; that he contributed to the attached Staff Recommendation and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.



Curt B. Gateley

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 2nd day of October, 2015.



NOTARY PUBLIC



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

In the Matter of the Joint Application of)
Hickory Hills Water & Sewer Co., Inc. and)
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Case No. WA-2016-0019

AFFIDAVIT OF PAUL R. HARRISON

State of Missouri)
) ss.
County of Cole)

AFFIDAVIT

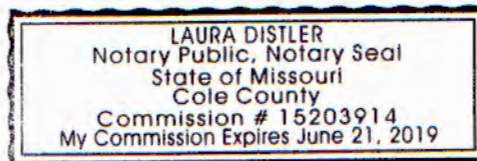
COMES NOW Paul R. Harrison and on his oath declares that he is of sound mind and lawful age; that he contributed to the attached Staff Recommendation and that the same is true and correct according to his best knowledge and belief.
Further the Affiant sayeth not.

Paul R. Harrison
Paul R. Harrison

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 2nd day of October, 2015.

Laura Distler
NOTARY PUBLIC



BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of)
Hickory Hills Water & Sewer Co., Inc. and)
Missouri-American Water Company, for)
MAWC to Acquire Certain Water and)
Sewer Assets of Hickory Hills and, in)
Connection Therewith, Issue Indebtedness)
and Encumber Assets)

Case No. WA-2016-0019

AFFIDAVIT OF DERICK MILES, PE

State of Missouri)
) ss.
County of Cole)

AFFIDAVIT

COMES NOW Derick Miles, PE and on his oath declares that he is of sound mind and lawful age; that he contributed to the attached Staff Recommendation and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

Derick Miles, PE
Derick Miles, PE

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 2nd day of October, 2015.

Laura Distler
NOTARY PUBLIC

