

**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
Assets and for a Certificate of
Convenience and Necessity

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Case No. WA-2019-0299
Consolidated with SA-2019-0300

SECOND BRIEF OF THE MISSOURI OFFICE OF THE PUBLIC COUNSEL

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June 2, 2020

PUBLIC

Review of the issues raised in the second hearing:

Issue 1. What is the net book value of the Port Perry Service Company's ("Port Perry") water and wastewater assets?

The Missouri Office of the Public Counsel ("OPC"); Confluence Rivers Utility Operating Company, Inc. ("Company" or "Confluence Rivers"); and the Staff of the Missouri Public Service Commission ("Staff") together filed a *Stipulation and Agreement as to Net Book Value* on April 9, 2020. This stipulation and agreement stated that the net book value of the Port Perry water and wastewater assets, as of December 31, 2019, was \$20,070 for Port Perry's water assets and \$57,866 for its wastewater assets. *Stipulation and Agreement*, pg. 2. The Lake Perry Lot Owners Association ("Association") filed a partial objection to the stipulation on April 10, 2020, **but that partial objection expressly stated that the Association agreed with the actual dollar valuations of the water and wastewater systems included in the April 9th Stipulation and Agreement as to Net Book Value.** *Partial Objection*, pg. 1. No party has opposed or otherwise challenged these values.

The Company and Staff have both submitted testimony in support of the dollar amounts included in the April 9th *Stipulation and Agreement as to Net Book Value*. Bolin, *Direct*, pg. 5 lns. 9 – 15; Cox, *Rebuttal*, pg. 3 ln. 25 – pg. 4 ln. 5. Moreover, the testimony submitted by the Association also accepts these valuations as accurate in the course of presenting the larger argument for why this transaction is detrimental to the public interest. DeWilde, *Rebuttal*, pg. 2

ln. 11 – pg. 3 ln. 17. There is thus no disagreement among the parties as to the net book value of the Port Perry water and wastewater assets. Given the complete consensus among all the parties, the Commission should find that the net book value of the Port Perry water and wastewater assets, as of December 31, 2019, are \$20,070 for Port Perry’s water assets and \$57,866 for its wastewater assets.

Issue 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. The Commission should instead find that Confluence Rivers’ acquisition of the Port Perry water and wastewater assets and certificates of convenience and necessity is detrimental to the public interest and deny approval of the transaction. The OPC explained the rationale for this determination extensively in its initial brief. As such, the OPC will not reiterate those same points again here. Instead, the OPC will focus its analysis exclusively on the detriment associated specifically with the net book value of the system and the resulting drastic over-payment Confluence Rivers has made. *See DeWilde, Rebuttal*, pg. 3.

As explained in the testimony of Association witness Richard DeWilde, “[t]he stated purchase price is _____ ** of the net book value.” DeWilde, *Rebuttal*, pg. 3 lns. 3 – 4. This means that “[t]he difference between the stated purchase price and the net book value is ** _____ ** *Id.* lns. 4 – 5. Now Mr.

DeWilde does acknowledge that the purchase agreement executed by Confluence includes a provision that states: "The Parties further agree that, in the event the Missouri Public Service Commission determines the net book value of the Assets is less than ** _____ **

Buyer has the option of paying ** _____
_____ ** for the Assets or terminating this Agreement." *Id.* lns. 7 – 11.

However, Mr. DeWilde points out that, even at this lower price, the purchase price would still be ** _____
_____ ** *Id.* lns. 12 – 13. There can thus be no question that Confluence is greatly overpaying for this system.

The existence of Confluence's willingness to significantly overpay for this system has already had a major effect on this case and will likely continue to have an effect moving forward. As Mr. DeWilde explained in testimony:

The price is so far beyond what is reasonable that it makes it impossible for other viable transaction to have an opportunity to bid. A ** _____ ** "acquisition premium" plus the two-year employment contract was a clear economic hurdle that prevented any other buyer getting Port Perry's ear. It certainly prevented the Association from having an opportunity to make an offer that Port Perry would consider. The Association attempted to speak with Port Perry on several occasions and even offered them a contingent offer in the event the CRU transaction did not go forward. That acquisition premium simply shut down the market and assured a nontransparent marketplace. Ultimately, such a marketplace will unreasonably inflate prices.

Id. pg. 6 lns. 4 – 11. Nor can Confluence provide a good reason for their decision to overpay.

During the evidentiary hearing, Confluence witness Josiah Cox was asked a very simple question by the Commission, “why does Confluence want to purchase the system if the net book value is so far below the sales price and the company has stated that it will not seek an acquisition premium?” Tr. Pg. 379 lns 2 – 5. Mr. Cox offered two answers in response; both were obvious nonsense. First, Mr. Cox basically outlined his company’s primary business model of buying up smaller (often distressed) systems. Tr. Pg. 379 lns 7 – 14. Apparently, we are to take this to mean that Mr. Cox sees his company as something of a “charity” and is thus willing to lose significant money if it means acquiring any small water or wastewater system. This is obviously false.

Confluence is a “for profit” enterprise, not a charity. In fact, Confluence (or one of its sister entities) has now twice asked this Commission to award it an “acquisition incentive” related to its attempt to acquire other small water and wastewater systems. *See* WA-2019-0185, *Report and Order*, pgs. 8, 29 (noting that Osage Utility Operating Company (which is also owned by CSWR, LLC.) sought an acquisition premium related to the purchase of the assets of the Osage Water Company); WM-2020-0282, *Application for Acquisition Incentive Related to the Acquisition of the Terre Du Lac Nonviable Water and Sewer Systems*, pg. 1. Given that Confluence (or one of its sister subsidiaries) have now twice sought an acquisition incentive under a regulation that requires proof that “[t]he acquisition would be unlikely to occur without the probability of obtaining an acquisition incentive,” there is an obvious and tremendous deal of insincerity in Mr. Cox’s statement that the Company is willing to

acquire any small water or wastewater system – at a loss no less – just because “that is what it does.” *See* 20 CSR 4240-10.085(4)(I).

The second excuse Mr. Cox offers fares no better than his first. Mr. Cox attempts to downplay the significance of the over-payment by comparing it to the total capitalization of his company and its parent. Tr. Pg. 380 lns 4 – 9. The problems with this line of thinking should be obvious on its face. The fact that a utility has already heavily invested in other areas does not and should not be considered as an excuse to make an overpayment on some other investment. Mr. Cox’s line of thinking here is the direct logical equivalent to a large electric company saying, “We know we are paying three times more than necessary to build this windfarm, but the cost of the windfarm is only 10% of the cost of all of our other generating facilities so it does not matter.” Such an argument would hopefully be dismissed out of hand by the Commission for being a display of horrible mismanagement. Yet here we have Confluence making effectively the exact same argument. Mr. Cox is claiming that it does not matter that the Company is willing to over-pay for the Port Perry water and wastewater systems, because it has managed to spend considerably more money on *other* systems. If anything, Confluence’s apparent willingness to behave imprudently when purchasing this system just because it feels like it can “absorb the losses” due to overinvestment in other systems should be seen as a sign of categorical mismanagement; not an excuse to give the Company control of the Port Perry system.

Strip away the chaff of Mr. Cox’s irrational answer to the Commission’s simple question and one will be saddened to see that nothing remains to justify this

purchase. Instead, the only reasonable conclusion to be drawn given this over-payment is the one reached by Association witness Glen Justis who laid out the following actions Confluence could take to improve the profitability of the deal for the benefit of its investors:

In my professional view, based on experience working with public utilities as well as commonly-accepted financial principles, I see five main scenarios, as follows:

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.
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.
6. A combination of the above.

Justis, *Rebuttal*, Pg. 3 ln 21 – pg. 4 ln 14. The over-payment Confluence seeks to make in this case will almost certainly lead to one of these five troubling scenarios.

As the OPC laid out in its initial brief, there are a plethora of ways in which the transaction proposed in this case will be detrimental to the public's interest. The

overly high purchase price Confluence intends to pay is merely one more reason to be added to the stack; one more brick in the wall. If the Commission should approve this sale, then the customers of the Port Perry system will invariably end up paying far more than they otherwise would ever have needed to pay had this sale been denied. Moreover, when that inevitable, overly-large price-hike comes, the concerns of the people who put so much effort into having their voices heard – only to be ultimately ignored – will be vindicated. Unfortunately, one must assume this fact will be rather cold comfort to those Missouri citizens that are about to be harmed.

WHEREFORE, the Office of the Public Counsel respectfully requests the Commission accept this *Second Brief* and grant the relief requested herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the forgoing have been mailed, emailed, or hand-delivered to all counsel of record this Second day of June, 2020.

 /s/ John Clizer