

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

In the Matter of the Application of Osage Utility)
Operating Company, Inc. to Acquire Certain)
Water and Sewer Assets and for a)
Certificate of Convenience and Necessity)

Case No. WA-2019-0185

STAFF'S INITIAL BRIEF

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Introduction

Osage Utility Operating Company, Inc. (OUOC) filed an *Application and Motion for Waiver* seeking to acquire certain water and sewer assets and the certificates of convenience and necessity (CCN) in the four service areas of Osage Water Company (OWC) and the single service area of Reflections Subdivision Master Association, Inc., and Reflections Condominium Owners Association, Inc., on December 19, 2018. OUOC's *Application* also included a request for an acquisition incentive pursuant to Commission Rule 20 CSR 4240 10.085. On February 19, 2019, OUOC filed an *Amended Application and Motion for Waiver*, to correct inaccuracies discovered after the filing of the original *Application*. Lake Area Waste Water Association, Inc., Missouri Water Association, Inc., Public Water Supply District No. 5 of Camden County Missouri, Cedar Glen Condominium Owners Association, Inc., Reflections Condominium Owners Association, Inc., and jointly Great Southern Bank and the Reflections Subdivision Master Association, Inc., filed *Motions to Intervene*, which the Commission granted. The Commission scheduled a prehearing conference, which was held February 20, 2019, at which a procedural schedule was proposed and later approved by the Commission. Pursuant to that agreed-upon schedule Staff initially agreed to file its recommendation no later than April 30, 2019, which the Commission extended upon request to May 14, 2019. Following the filing of Staff's recommendation, several parties filed responses to the recommendations and the parties agreed a procedural schedule was needed to establish dates for filing testimony and an evidentiary hearing. Great Southern Bank and Reflections Condominium Owners Association filed testimony stating that the purchase agreement between Central States Water Resources (CSWR), the parent company of OUOC, and Great Southern Bank to purchase the Reflections water and sewer systems had been terminated. The Office of the Public Counsel (OPC) filed a request to bifurcate the Reflections issues from the evidentiary hearing and the Commission granted its request. The Commission ordered Staff to file an amended Recommendation regarding only the OWC systems, which it filed in Supplemental Testimony on September 13, 2019. The evidentiary hearing regarding only the OWC systems was held September 17 and 18.

Case Background

The OWC systems OUOC seeks to acquire are presently in receivership. The Commission originally placed them into receivership in proceedings commencing in Case No. WC-2003-0134 and finalizing in the Circuit Court of Camden County on October 21, 2005.¹ The receiver was unsuccessful in his attempts to liquidate the assets of the OWC systems, and ultimately filed for bankruptcy on August 28, 2017; a bankruptcy trustee has overseen proceedings and the assets since that time.²

This proceeding is unique in that rather than OUOC negotiating a purchase of the CCNs and system assets directly with the owner of OWC, OUOC was instead the stalking horse bidder³ on the OWC systems through a bankruptcy auction process following the OWC receiver's filing of a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code, Case No. 17-42759-drd11 currently pending in the U.S. Bankruptcy Court for the Western District of Missouri.⁴ A stalking horse bidding process is defined as one where a debtor enters into an agreement with a bidder or purchaser in advance of an auction for the sale of the debtor's assets.⁵ The agreed to amount serves as an initial bid which is the base-line for the auction once approved by the bankruptcy court.⁶ If a higher bid is not made at the auction then the stalking horse agreement becomes the asset purchase agreement.⁷ Throughout the bidding process, the stalking horse is given the opportunity to match any higher bids. The stalking horse bidding process is common under Section 363 of the U.S. Bankruptcy Code.⁸ For the Commission's information, Staff included a letter with the filing of its Recommendation from the law firm Spencer Fane, which represents the bankruptcy trustee in Case No. 17-42759-drd11, and is included in witness Dietrich's direct testimony as Schedule ND-d2. The attachment explains the process undertaken in relation to the

¹ Ex. 1, Cox Direct P. 11:18-12:9.

² *Id.* at 12:25-13:10.

³ Ex. 100C, Dietrich Direct Schedule ND-d2. (The Company stated at the evidentiary hearing that it did not seek to be the stalking horse bidder and had no prior knowledge of that process.)

⁴ Tr. 122:11-23.

⁵ Ex. 100C, Dietrich Direct Schedule ND-d2, Pp. 9-14.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

relevant bankruptcy auction and includes relevant filings from the proceeding explaining the bidding procedure, auction instructions, notice of the auction's results, and the order of sale by the bankruptcy court.⁹ In summary, the letter explains that the Commission appointed a receiver in keeping with Commission directives to liquidate OWC's assets and voluntarily filed a petition for Chapter 11 bankruptcy for OWC once his attempts to sell the assets failed.¹⁰ The appointed bankruptcy trustee identified Central States Water Resources (CSWR), the parent company of OUOC, as a potential stalking horse purchaser and successful negotiations with CSWR ultimately resulted in a stalking horse asset purchase agreement.¹¹ The agreement permitted the trustee to solicit additional bids and an auction was held between all interested parties.¹² CSWR matched all competing bids at the auction and was ultimately declared the successful purchaser.¹³

Staff's Investigation

The OWC systems are in varying degrees of disrepair, and most require upgrades to comply with DNR regulations.¹⁴ As part of its application, OUOC proposed various improvements it views as necessary to bring them into compliance.¹⁵ These proposals were based on preliminary reviews conducted by OUOC's engineers and included broad cost estimates.¹⁶ It is not unusual for proposed improvements to be modified due to information not yet available, such as underground site conditions, integrity of the collection system, commodity prices impacting decisions on materials used in construction, etc.¹⁷ Staff Witness David Roos testified that he conducted a review of the OWC systems and found the improvements proposed by OUOC to be reasonable given the information available, and consistent with similarly situated water and sewer utilities.¹⁸

⁹ *Id.*

¹⁰ The receiver ultimately determined that filing for bankruptcy was appropriate after several judgements were levied against OWC, which added to an inability to liquidate the assets.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ Ex. 100C, Dietrich Direct Schedule ND-d2, Pp. 20-30.

¹⁵ Ex. 6, Thomas Direct Pp. 4-23.

¹⁶ Ex. 100C, Dietrich Direct Schedule ND-d2, P. 20.

¹⁷ Tr. 252:21-253:2.

¹⁸ Tr. 256:8-12.

Witness Roos generally agreed with OUOC's proposals, but provided critiques, specifically regarding OUOC's proposal to replace the master meter at Chelsea Rose despite its relatively young age.¹⁹ Additionally, Staff will require that "...further details and justification will be necessary if OUOC seeks inclusion of an MBBR upgrade in rates during the next rate case."²⁰ Staff also included specific recommendations that a sewage bypassing at the Cimmaron Bay and Eagle Woods sewer systems caused by neglect of the systems needs to be repaired in no less than 90 days, to which OUOC has agreed.²¹

When providing a recommendation in an acquisition case, Staff focuses on reporting the facts and observations gained through its investigation.²² While Staff reviewed OUOC's preliminary proposed improvements in this case for reasonableness, the prudence of actually making those improvements is not examined in an acquisition case; prudence will be examined in the context of a rate request, after any improvements have been put into service, when the utility proposes to receive recovery of its investment in rates.²³ In that rate proceeding, the utility presents its supporting documentation such as engineering reports, performance, and final costs for the improvements and Staff conducts a complete review of those improvements and costs.²⁴ Due to this proceeding being a transfer application, Staff reviewed CSWR's (as the parent company of OUOC) performance history with its other Missouri utility systems regarding its technical, managerial, and financial (TMF) capabilities.²⁵ This review also included reviewing specific factors to the OWC properties such as who OUOC intends to retain as a certified contract operator(s), potential challenges associated with operating the OWC systems,²⁶ and the proposed repairs that OUOC had recommended to each of the systems.²⁷

¹⁹ Ex. 100C, Dietrich Direct Schedule ND-d2, P. 10.

²⁰ *Id.* at P. 8.

²¹ Ex. 1 Cox Direct, Pp. 26-28.

²² Ex. 100C, Dietrich Direct Schedule ND-d2, P. 8.

²³ *Id.* at P. 17.

²⁴ Tr. 242:5-8.z

²⁵ Ex. 105C Dietrich Supplemental Schedule ND-d2, P. 20.

²⁶ Ex. 100C, Dietrich Direct Schedule ND-d2, Pp. 20-30.

²⁷ *Id.* at P. 22.

In summary, although Staff did not conduct a prudency review on the preliminary proposals, Staff believes OUOC's plan for its proposed improvements at this point is generally reasonable and will lead to safe and adequate service to the customers on the OWC systems.

Staff's Recommendation

Staff recommends that the Commission approve the OUOC Application to acquire the OWC CCN as well as the assets of those water and sewer systems.²⁸ It further recommends that the Commission find that OUOC has met the requirements of 20 CSR 4240-10.085, and be approved to apply for consideration of a debit acquisition premium related to the purchase price of the OWC systems in its first rate case for the systems.²⁹ For purposes of providing the Commission guidance on OUOC's request for an acquisition premium, Staff proposed in Staff's Revised Recommendation a methodology for estimating the debit acquisition premium. Staff's method uses the initial offer agreed to between OUOC and the bankruptcy trustee to acquire the OWC systems and the rate base value for OWC as of December 31, 2018. The actual terms of any acquisition premium will be finally determined in OUOC's first rate case.³⁰ Staff has additionally delineated several recommendations, which OUOC has verbally agreed to should the Commission order those recommendations.³¹ These recommendations are:

1. Authorize OWC to sell and transfer utility assets to OUOC, and transfer the CCN's currently held by OWC to OUOC upon closing on any of the respective systems;
2. Upon closing on each of the OWC water and sewer systems, authorize OWC to cease providing service, and authorize OUOC to begin providing service;
3. Require OUOC to file Tariff Adoption Notice tariff sheets for the corresponding water and sewer tariffs of the regulated OWC systems within ten (10) days after closing on the OWC assets;
4. Upon closing on each of the water and sewer systems, authorize OUOC to provide service by applying, on an interim basis, the existing rates, rules and

²⁸ Ex. 100C, Dietrich Direct Schedule ND-d2, P. 38.

²⁹ *Id.* at 36.

³⁰ Tr. 239:22-240:6..

³¹ Ex. 1 Cox Direct, Pp. 26-28.

- regulations as outlined in OWC's water tariff and sewer tariff, until the effective date of respective adoption notice tariff sheets, as recommended above;
5. Require OUOC to create and keep financial books and records for plant-in-service, revenues, and operating expenses (including invoices) in accordance with the NARUC Uniform System of Accounts;
 6. Require OUOC to, going forward, keep and make available for audit and review all invoices and documents pertaining to the capital costs of constructing and installing the water and sewer utility assets;
 7. Approve depreciation rates for water and sewer utility plant accounts as described and shown herein;
 8. Require OUOC to distribute to all customers an informational brochure detailing the rights and responsibilities of the utility and its customers regarding its water service, consistent with the requirements of Commission Rule 4 CSR 240-13, within thirty (30) days after the effective date of approval of a CCN by the Commission;
 9. Require OUOC to, within ninety (90) days of the effective date of a Commission order approving OUOC's Application, complete repairs to resolve the bypassing of treatment at any wastewater treatment system;
 10. Resolve all issues regarding noncompliance with Missouri Department of Natural Resources (DNR) regulations for all water and sewer systems;
 11. Require OUOC to provide adequate training for the correct application of rates and rules to all customer service representatives, including those employed by contractors, prior to the customers receiving their first bill from OUOC;
 12. Require OUOC to provide to the Customer Experience Department Staff a sample of ten (10) billing statements of bills issued to OWC customers within thirty (30) days of such billing;
 13. Require OUOC to file notice in this case once Staff's recommendations regarding customer communications and billing, listed above, have been completed; and
 14. Require OUOC to file a rate case with the Commission no later than twenty-four (24) months after the effective date of an order approving OUOC's Application³²

³² Ex. 100C, Dietrich Direct Schedule ND-d2, Pp. 16-18.

Standard for Request for Acquisition of existing regulated water or sewer utility

The transaction before the Commission includes the sale of substantially all of the water and sewer assets of OWC to OUOC, along with the associated CCNs authorizing OWC to provide service. At the evidentiary hearing, there was some question as to the appropriate standard to apply. As an initial matter, OUOC's *Application* requests authority from the Commission for OWC to sell, and OUOC to acquire, the assets of OWC, including the OWC CCNs; or in the alternative, grant the OUOC new CCNs to provide water and sewer service in the area now served by OWC.

The statutory basis for the Commission's jurisdiction to approve the sale of assets that are necessary or useful in the performance of a public utilities' duties is found in Section 393.190.1, RSMo, which states:

No gas corporation, electrical corporation, water corporation or sewer corporation shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public utility, without having first secured from the commission an order authorizing it so to do.

While the terms "certificate" or "convenience and necessity" are not explicitly included in Section 393.190, RSMo, a CCN is certainly "necessary or useful" in the performance of a utility's duties, and the Commission has in the past ordered the transfer of CCNs from one regulated utility to another.³³ In addition, the Commission's Rule formalizing the filing requirements for Applications for Authority to Sell, Assign, Lease, or Transfer Assets,³⁴ contemplates the transferability of CCNs. Subsection (1) of the rule states:

³³ See Commission Case Nos. EM-91-29 and EM-91-404.

³⁴ Commission Rule 20 CSR 4240-10.105.

(1) In addition to the requirements of 4 CSR 240-2.060(1), applications for authority to sell, assign, lease or transfer assets shall include:

- (A) ***A brief description of the property involved in the transaction, including any franchises, permits, operating rights or certificates of convenience and necessity,***
- (B) A copy of the contract or agreement of sale;
- (C) The verification of proper authority by the person signing the application or a certified copy of resolution of the board of directors of each applicant authorizing the proposed action;
- (D) The reasons the proposed sale of the assets is not detrimental to the public interest;
- (E) If the purchaser is subject to the jurisdiction of the commission, a balance sheet and income statement with adjustments showing the results of the acquisitions of the property; and
- (F) A statement of the impact, if any, the sale, assignment, lease or transfer of assets will have on the tax revenues of the political subdivisions in which any structures, facilities or equipment of the companies involved in that sale are located. (emphasis added).

While there is no doubt that Section 393.190, RSMo, effectively anoints the Commission as the *gatekeeper* for the transfer of necessary utility plant, the statute does not delineate a standard to apply in such cases. However, the Missouri Supreme Court ruling in *State Ex Rel. City of St. Louis v. Public Service Com'n of Missouri*, after reading this section in conjunction with other provisions of the Public Service Commission Act, held that “[a] property owner should be allowed to sell his property *unless it would be detrimental to the public.*” (emphasis added).³⁵ In further explaining its conclusion, the Court quoted a Supreme Court decision from the State of Maryland,³⁶ which at the time had an identical statute. That court stated:

To prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of public service commissions. It is not their province to insist that the public shall be benefited, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the

³⁵ *State Ex Rel. City of St. Louis v. Public Service Com'n of Missouri*, 73 S.W.2d 393, 458-459.

³⁶ *Electric Public Utilities Co. v. Public Service Commission*, 140 A. 840, loc. Cit. 844.

public detriment. 'In the public interest,' in such cases, can reasonably mean no more than 'not detrimental to the public.'"³⁷

The Missouri Court of Appeals reiterated this standard in *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz* when it held, "Before a utility can sell assets that are necessary or useful in the performance of its duties to the public it must obtain approval of the Commission. Section 393.190 RSMo. (1969). The obvious purpose of this provision is to *ensure the continuation of adequate service to the public served by the utility.*" (*emphasis added*).³⁸ The Court went on to state, "[t]he Commission may not withhold its approval of the disposition of assets unless it can be shown that such disposition is detrimental to the public interest."³⁹

The public interest also determines the applications for certificates as part of the statutory standards of convenience and necessity.⁴⁰ That standard includes a variety of considerations:

The term "necessity" does not mean "essential" or "absolutely indispensable," but that an additional service would be an improvement justifying its cost. Additionally, what is necessary and convenient encompasses regulation of monopoly for destructive competition, prevention of undesirable competition, and prevention of duplication of service. The safety and adequacy of facilities are proper criteria in evaluating necessity and convenience as are the relative experience and reliability of competing suppliers. Furthermore, it is within the discretion of the Public Service Commission to determine when the evidence indicates the public interest would be served in the award of the certificate.⁴¹

In cases such as the one at hand, the Commission has previously made a determination that it would be convenient and necessary for the existing utility to provide

³⁷ *State ex rel. City of St. Louis v. Public Service Commission of Missouri, et al.* 73 SW 2d 393. 1.c. 400. S.C. Mo. (1934).

³⁸ *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo. Ct. App. 1980).

³⁹ *Id.*

⁴⁰ Section 393.170.3, RSMo.

⁴¹ *State ex rel. Intercon Gas, Inc. v. Pub. Serv. Comm'n of Missouri*, 848 S.W.2d 593, 597-98 (Mo. App. W.D. 1993).

water and sewer service to the area; the Commission originally did so for the original service area of OWC in Case No. WA-89-73. The Commission typically applies what are known as the “Tartan Factors”⁴² when determining whether the issuance of a new CCN would be convenient and necessary for the public service. In an acquisition case involving the transfer of the assets of an existing regulated water or sewer utility to another, or in a case where the acquiring entity will become a regulated water or sewer utility, Staff considers whether a transfer would ensure adequate service by reviewing the TMF capacity of the entity requesting acquisition.⁴³ These criteria originate in Section 640.115, RSMo, and have been historically applied by Staff, and the Commission, when reviewing all relevant water and sewer cases. Both the Tartan Factors and the TMF capacities consider similar elements. The Commission historically has considered factors akin to TMF capacity and the Tartan Factors in determining prior acquisition cases.⁴⁴ For instance, in *In Re: Missouri Gas Company*, the Commission focused on the purchaser’s 1) history of providing utility service; 2) lack of notable service or economic difficulties; 3) financial position to provide stability, capability and commitment; 4) financial capacity to absorb the proposed transaction, and; 5) ability to successfully operate the asset (in that case a transportation pipeline) efficiently and economically.⁴⁵ In the instance of issuing a new CCN for an acquiring utility to serve an already certificated area as part of a transfer of assets, a consideration of such elements is inherent in an analysis of whether the transaction would be detrimental to the public interest.

⁴² The Tartan Factors arose out of an acquisition case requesting issuance of a new CCN by the Tartan Energy Company. The Tartan Factors contemplate a 1) need for service, 2) the utility’s qualifications, 3) the utility’s financial ability, 4) the feasibility of the proposal, and 5) promotion of the public interest.

⁴³ Ex. 105C Dietrich Supplemental Schedule ND-d2 at P. 20.

⁴⁴ *In re: Missouri Gas Company*, Mo.P.S.C. Case No. GM-94-252 (Oct. 12, 1994).

⁴⁵ *Id.*

Not Detrimental to the Public Interest

The Missouri Court of Appeals views “not detrimental to the public interest” as a balancing test,

“The standard of “not detrimental to the public” adopted by the Court in *City of St. Louis* balances the rights of private investors to transfer their interests in a regulated utility against the right of the public served by the utility not to be harmed by such a transfer. *Id.* In 1975, the detriment standard was codified by the PSC in 4 CSR 240–2.060(8)(D)⁴⁶, requiring that applicants seeking approval to merge under § 393.190 include in their applications “[t]he reasons the proposed merger is not detrimental to the public interest.”⁴⁷

“The Commission has recognized that while the phraseology of this standard is somewhat awkward, it is supported by both Commission rule (4 CSR 240-2.060(5)) and case law.”⁴⁸ In its *Report and Order on Rehearing* in Case No. EO-2004-0104, an acquisition case involving a transfer of assets to Union Electric Company the Commission provided some clarity on the standard, after the parties to that matter had some debate as to the proper way to apply the “not detrimental” standard.⁴⁹ The Commission stated,

The Missouri Supreme Court had an opportunity but did not announce a new standard for asset transfers in *AG Processing*, but rather restated the existing “not detrimental to the public” standard. In particular, the Court clarified the analytical use of the standard. **What is required is a cost-benefit analysis in which all of the benefits and detriments in evidence are considered.** The *AG Processing* decision does not, as Public Counsel asserts, require the Commission to deny approval where a risk of future rate increases exists. Rather, **it requires the Commission to consider this risk together with the other possible benefits and detriments and determine whether the proposed transaction is likely to be a net benefit or a net detriment to the public. Approval should be based upon a finding of no net detriment.**

⁴⁶ The standard can now be found in 20 CSR 4240-10.105.

⁴⁷ *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n of State of Missouri*, No. WD60631, 2003 WL 1906385, at *7 (Mo. Ct. App. Apr. 22, 2003), as modified (May 27, 2003); Citing *City of St. Louis*, 73 S.W.2d at 400 (emphasis added).

⁴⁸ *Re: Missouri American Water Company*, Mo.P.S.C. Case No. WM-93-255 (July 30, 1993), citing *State ex rel. Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466 (Mo. App, 1980).

⁴⁹ *In Re Union Elec. Co.*, No. EO-2004-0108, 2004 WL 2419478, at *23–24 (Oct. 6, 2004).

The Commission went on to state:

In considering whether or not the proposed transaction is likely to be detrimental to the public interest, the Commission notes that its duty is to ensure that UE provides safe and adequate service to its customers at just and reasonable rates. A detriment, then, is any direct or indirect effect of the transaction that tends to make the power supply less safe or less adequate, or which tends to make rates less just or less reasonable. The presence of detriments, thus defined, is not conclusive to the Commission's ultimate decision because detriments can be offset by attendant benefits. The mere fact that a proposed transaction is not the least cost alternative or will cause rates to increase is not detrimental to the public interest where the transaction will confer a benefit of equal or greater value or remedy a deficiency that threatens the safety or adequacy of the service.⁵⁰

To summarize the Commission's conclusions, "not detrimental to the public interest" is the correct standard to apply to acquisition cases as it has been sanctioned by the Supreme Court of Missouri itself. Additionally, the consideration of that standard is a balancing test of the net benefits to the net detriments. If the net benefits outweigh the net detriments then an acquisition can be found to be, "not detrimental to the public interest." Furthermore, it is proper to consider future ratemaking effects, however, a potential for an increase in rates alone is insufficient to deny an application where the transaction will, "remedy a deficiency that threatens the safety or adequacy of the service."⁵¹

Staff's Argument

Would the sale of Osage Water Company's certificates of convenience and necessity and its water and sewer assets to Osage Utility Operating Company be detrimental to the public interest?

OUOC's acquisition of the Osage Water Company systems (Cedar Glen, Eagle Woods, Cimmaron Bay and Chelsea Rose) would not be detrimental to the public interest. OWC is a troubled system, in serious need of repair and a capable owner. OUOC's affiliates (Hillcrest Utility Operating Company, Indian Hills Utility Operating Company, Raccoon Creek Utility Operating Company, Elm Hills Utility Operating

⁵⁰ *In Re Union Elec. Co.*, No. EO-2004-0108, 2004 WL 2419478, at *23-24 (Oct. 6, 2004).

⁵¹ *Id.*

Company and Confluence Rivers Utility Operating Company) have acquired many troubled systems as part of their acquisitions and have shown the Commission an ability to provide safe and adequate service that meets the Department of Natural Resources (DNR) requirements.⁵² The Commission in prior cases has found that all CSWR affiliates met the TMF criteria and Staff's evaluation of OUOC was also positive under the elements.⁵³ Additionally, OUOC's parent company, Central States Water Resources (CSWR), according to its witnesses, has also been approved to operate water and sewer systems in other states and is actively pursuing acquisitions in several additional states.⁵⁴

OUOC has requested to adopt the current rates for the systems; meaning there will be no immediate rate impact to the customers of the OWC systems. Further, OUOC intends to purchase the systems using an equity infusion from its investors, and has not presently applied for any financing approval related to the acquisition of the OWC systems, and has committed to coming before the Commission for approval of any necessary financing in the future.⁵⁵ As referenced above, determining whether an application is not detrimental to the public interest is a balancing test.⁵⁶ Staff in its review of the *Application* also considered that balance of benefits to detriments. Based on the history of OUOC's parent company, CSWR, and the affiliate companies which it operates, the troubled nature of the systems and length of time those systems have been in receivership and the financial plans laid out in OUOC's application, Staff finds that the

⁵² See *In the Matter of the Joint Application of Brandco Investments, LLC and Hillcrest Utility Operating Company, Inc. for Hillcrest to Acquire Certain Water and Sewer Assets of Brandco and, In Connection Therewith, Issue Indebtedness and Encumber Assets* SO-2014-0341 and WO-2014-0340; *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* SO-2015-0013 and SM-2015-0014; *In the Matter of the Application of Indian Hills Utility Operating Company, Inc. to Acquire Certain Water Assets of I.H. Utilities, Inc. and, in Connection Therewith, Issue Indebtedness and Encumber Assets* WO-2016-0045; *In the Matter of the Application of Elm Hills Utility Operating Company, Inc. and Missouri Utilities Company for Elm Hills to Acquire Certain Water and Sewer Assets of Missouri Utilities Company, for a Certificate of Convenience and Necessity, and, in Connection therewith, to Issue Indebtedness and Encumber Assets* SM-2017-0150 and WM-2017-0151; *In the Matter of the Application of Confluence Rivers Utility Operating Company, Inc. to Acquire Certain Water and Sewer Assets, For a Certificate of Convenience and Necessity, and, in Connection Therewith, To Issue Indebtedness and Encumber Assets* SM-2017-0117 and WM-2018-0116.

⁵³ Ex. 105C Dietrich Supplemental Schedule ND-d2, P. 20.

⁵⁴ Ex. 1, Cox Direct P. 6:3-20.

⁵⁵ Ex. 1, Cox Direct P. 10:13-20.

⁵⁶ *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n of State of Missouri*, No. WD60631, 2003 WL 1906385, at *7 (Mo. Ct. App. Apr. 22, 2003), as modified (May 27, 2003); Citing *City of St. Louis*, 73 S.W.2d at 400 (emphasis added).

benefits outweigh the detriments and that OUOC has demonstrated that its acquisition of OWC would not be detrimental to the public interest.

In considering the successful history of OUOC's affiliates, this Commission recently applied the standard of "not detrimental to the public interest" in an acquisition case involving an affiliate of OUOC, Confluence Rivers Operating Company (Confluence Rivers).⁵⁷ In its *Report and Order* the Commission found that the proposed sale of multiple systems to Confluence Rivers was not detrimental to the public interest and stated, "Considering the present troubled nature of the systems at issue, the Company's sound track record in rehabilitating similarly situated systems, the Company's ability to acquire, maintain, and operate the systems, and the statutory obligation of the Commission to ensure safe and adequate service, allowing the Company to acquire the Selling Companies' assets per the terms and conditions of the Stipulation will not be detrimental to the public."⁵⁸

OUOC's affiliates have a solid track record of providing safe and adequate service.⁵⁹ At least one system operated by each of those affiliates was in a similar state of disrepair to OWC at the time of its acquisition and the OUOC affiliate has made substantial improvements.⁶⁰ Staff's review of the OUOC proposals leads it to believe that Commission approval of OUOC's *Application* will also result in positive improvements to the OWC systems. Staff believes that OUOC has the knowledge, finances, stability, capability and commitment to operate the OWC systems efficiently and economically.

Parties to the case have made arguments that the proposed improvements of OUOC are more than what is necessary at the OWC systems. However, Staff conducted a review of the proposed improvements and found them to be proper and consistent with the improvements of other water and sewer utilities.⁶¹ In fact, the Office of the Public Counsel challenged Staff's recommendation, but on the stand its witness admitted that it has not previously challenged the comparable repair estimates or

⁵⁷ *In the Matter of the Application of Confluence Rivers Utility Operating Company, Inc. to Acquire Certain Water and Sewer Assets, For a Certificate of Convenience and Necessity, and, in Connection therewith, to Issue Indebtedness and Encumber Assets*, Order Approving Stipulation and Agreement and Granting Certificates of Convenience and Necessity, Mo. Pub. Serv. Comm'n., Pg. 4, Case No. WM-2018-0116 (February 14, 2019).

⁵⁸ *Id.*

⁵⁹ Ex. 1 Cox Direct, Pp. 5:5-7:10.

⁶⁰ *Id.* at P. 7:11-22.

⁶¹ Tr. 258:23-259:1.

actual improvements of an OUOC affiliate, nor had it performed its own independent review of current proposed improvements.⁶² In fact, OPC's only argument against OUOC and in favor of the Joint Bidders appears to be the testimony of the Joint Bidders that their rates may be lower than the future rates of OUOC.⁶³ Unlike Staff's investigation, OPC could not state that it had visited the systems to conduct a visual inspection, nor had it researched compliance records.⁶⁴ Furthermore, although the Joint Bidders themselves claim they will provide service at lower future rates, in testimony and on the stand, witness Goss admitted that Lake Area Wastewater Association and Missouri Water Association had not evaluated any improvements to the troubled water and sewer systems of Eagle Woods, Cimmaron Bay, or Chelsea Rose.⁶⁵ To be clear, OUOC is not proposing to increase OWC's rates at this time and any improvements OUOC makes will not be included immediately in rates, but would first need to be included in a request for a rate increase before the Commission.⁶⁶ At that time Staff would conduct a prudency evaluation to determine if all costs OUOC sought to recover were prudent investments.⁶⁷ Staff's investigation in this case was proper to the extent of consideration for an acquisition case and revealed that OUOC's acquisition of the OWC systems would not be detrimental to the public interest.

As stated above in reference to other cases, the Court of Appeals has repeatedly held that the Commission, "may not withhold its approval of disposition of proceeds of sale of assets of utility unless it can be shown that such disposition is detrimental to public interest."⁶⁸ Furthermore, this Commission has explicitly stated that, "The continuation of adequate service must be the Commission's focus in an application to sell or transfer assets instituted under Section 393.190, RSMo."⁶⁹ Staff would attest that OUOC has met every historical consideration the PSC has applied to its acquisition cases and that it is

⁶² Tr. 321:2-7.

⁶³ Tr. 304:12-305:16.

⁶⁴ *Id.*

⁶⁵ Ex. 401, Goss Direct Pp. 4:1-4; 4:20-5:2; and 5:18-23.

⁶⁶ Tr. 53:2-7; 213:8-14; 239:9-16; and 279:2-9.

⁶⁷ *Id.*

⁶⁸ *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466 (Mo. Ct. App. 1980) Citing V.A.M.S. § 393.190.

⁶⁹ *In the matter of the Application of UtiliCorp United Inc., d/b/a Missouri Public Service, for authority to sell a part of its franchise, works or system*, Case No. GM-97-435 (October 15, 1998).

proper to approve this application for OUOC to acquire the water and sewer assets of the OWC systems.

Commission Consideration of Competing Bids

Staff has argued that this matter has been bogged down in arguments regarding competing bidders at the bankruptcy auction and those bidders' effect on the Commission's decision as to whether the application currently before it to acquire the OWC systems is or is not detrimental to the public interest. As was pointed out at the evidentiary hearing and in the Company's direct testimony, the OWC systems have been in receivership for 14 years while the receiver attempted to find a buyer for the systems.⁷⁰ The receiver filed for bankruptcy in August of 2017, and a bankruptcy trustee was charged with selling the systems assets on September 19, 2018; over a full month prior to the bankruptcy auction.⁷¹

The Commission is charged by statute with reviewing the application presented before it by an entity seeking acquisition.⁷² Staff has only those resources available to it to review an existing application and therefore, cannot perform an investigation of a competing proposal unless the competing entity also files an application for approval. The Joint Bidders to this matter have not filed an application for consideration. Therefore, Staff considered the Joint Bidders' arguments in its investigation and recommendations, but did not conduct a review to determine which bid created the greatest public benefit; as the Missouri Supreme Court stated in *State ex rel. City of St. Louis*, "It is not their province to insist that the public shall be benefited, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public detriment."⁷³

⁷⁰ Ex. 1, Cox Direct P. 13:13-21.

⁷¹ *Id.*

⁷² Section 393.130, RSMo.

⁷³ In *State Ex Rel. City of St. Louis v. Public Service Com'n of Missouri*, the Court quoted a Supreme Court decision from the State of Maryland, which at the time had an identical statute. That court stated "To prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of public service commissions. It is not their province to insist that the public shall be benefited, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public detriment. 'In the public interest,' in such cases, can reasonably mean no more than 'not detrimental to the public."

The Missouri Court of Appeals has made it abundantly clear in upholding prior decisions of the PSC that the primary element to consider is ‘the continuation of adequate service to the public’ and whether the request before the Commission was not detrimental to the public interest.⁷⁴ Additionally, despite the fact that some parties to this matter have proposed that it is proper for the Commission to pick and choose between competing bidders in the case of an agreement resulting from an auction, such as this matter, the Commission has established in previous rulings that it does not see its position as one of micromanaging investor owned utilities.⁷⁵ In fact, in that same case, the Commission followed language from an earlier case stating that it preferred ‘to allow utility management the flexibility to make both overall strategic planning decisions and more routine management decisions in a relatively unencumbered framework.’⁷⁶

The Commission proceeding *In the matter of the Application of UtiliCorp United* also presented some similarities to the matter at hand.⁷⁷ In that case, which involved the sale of a pipeline, Staff argued that the Agreement was detrimental to the public because there were proposals to purchase the pipeline made by Missouri Gas Energy (MGE) that Staff believed were superior to the Agreement presented to the Commission.⁷⁸ The Commission in that case found that the MGE proposals were not relevant to the question of whether the transaction at issue in the case was detrimental to the public interest.⁷⁹ The Commission stated, “the record is clear that these proposals had been withdrawn by the time the Williams' proposal was accepted. Simply because there may have been proposals more favorable to ratepayers at some point does not have much bearing on whether or not the current proposal is detrimental. The MGE proposals may form the basis for a challenge in a subsequent rate case to UCU's prudence in not accepting them and accepting the WNG offer instead, but they do not have any relevance to the issues in this case.”⁸⁰ While the Commission noted that the proposals had been withdrawn, it

⁷⁴ *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo. Ct. App. 1980).

⁷⁵ *In the Matter of the Application of Missouri-American Water Company for a Certificate of Convenience and Necessity to Lease, Operate, Control, Manage and Maintain a New Source of Supply in Andrew County, Missouri*, Case No. WA-97-46 and WF-97-241 (issued October 9, 1997).

⁷⁶ *Id.*

⁷⁷ *In the matter of the Application of UtiliCorp United Inc., d/b/a Missouri Public Service, for authority to sell a part of its franchise, works or system*, Case No. GM-97-435 (October 15, 1998).

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

did not stop its statement with that fact. Rather it went on to state that the competing proposals had no bearing on the matter at hand, but may be considered as to the weight of the evidence in a future rate case. Staff would argue that the same would apply here, to speculate about the possibility of a different result arising out of nothing more concrete than a competing proposal cannot be considered sufficient evidence such as to be considered detrimental to the public interest. In fact in the same UtiliCorp case the Company in its Reply Brief said, “Such speculation about the Commission’s future actions does not constitute substantial and competent evidence sufficient to find the proposed sale to be detrimental to the public interest, nor is it sufficient to deny MPS its incidents of ownership.”⁸¹

Based on the information known to Staff at this time, Staff sees no compelling evidence from the Joint Bidders that would allow the Commission to deny OUOC’s application. Staff would reference another prior order of this Commission in which it said, “In final assessment, LGC has managed only to show that there may be a possibility, should several contingencies occur among entities not directly involved in the sale, that a public detriment may later manifest itself.”⁸² The Commission found in that matter, just as the Commission should find in this matter, that a speculative argument was insufficient to deny the application.

Acquisition Premium

Should the Commission approve an acquisition premium for the acquisition of the Osage Water Company and Reflections Systems under 20 CSR 4240-10.085?

Commission Rule 20 CSR 4240-10.085 governs incentives for acquisitions of nonviable utilities and requires an acquiring entity to demonstrate: 1) that it is not a nonviable utility as that term is defined in the rule and that it will not be materially impaired by the acquisition; 2) that the acquiring entity maintains the necessary managerial, technical, and financial capabilities to operate the system(s) to be acquired; 3) that the utilities it seeks to acquire are nonviable utilities; 4) that the purchase price and

⁸¹ *Id.*

⁸² *In re: Missouri Gas Company*, Mo.P.S.C. Case No. GM-94-252 (Oct. 12, 1994).

financial terms of the acquisition are fair and reasonable terms reached through arm's length negotiations; 5) that any improvements necessary to make the system(s) viable will be done in a reasonable time period; 6) how managerial or operational deficiencies will be corrected within six months of acquisition, if possible; 7) how planned improvements and changes will correct deficiencies; 8) that the acquisition is in the public interest; and 9) that the acquisition would be unlikely to occur without the probability of obtaining an acquisition incentive.⁸³ The rule also requires the acquiring entity to make an effort to obtain records of the original cost of the utility along with accounting for contributions, services or property and construction.⁸⁴ If the Commission approves an acquisition premium as part of this proceeding, OUOC would need to file a rate case within the period of time ordered by the Commission.⁸⁵ Should the Commission approve OUOC's request, the Company must also track properly booked contributions in aid of construction, use proper accounting for all plant retirements and plants no longer considered used and useful, and maintain those amounts using prior records of the systems or, if prior records are unavailable, keep new records starting with the date of acquisition.⁸⁶ Pursuant to 20 CSR 4240-10.085.6, OUOC will also need to file a plant-in-service study supporting its request in its next general rate case; any disputes with the study will be resolved in that proceeding.⁸⁷

Staff's recommendation at this time is that OUOC should be granted only a debit acquisition premium, calculated as the difference between the initial offer made by OUOC to acquire the OWC systems through the initial agreement in the bankruptcy proceeding and the rate base values for OWC Staff determined as of December 31, 2018.⁸⁸ Should the Commission issue an order including a determination that a debit acquisition premium is proper, it would be considered as part of the first rate case held following OUOC's acquisition of the systems.⁸⁹

As evidenced in the explanation of the Commission in *In Re Utilicorp United, Inc.* there are benefits to an ordered directive regarding acquisition adjustments, which Staff

⁸³ 20 CSR 4240-10.085

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ Ex. 105C Dietrich Supplemental, Confidential Scheduled ND-d2, Pp. 23-24.

⁸⁹ Tr. 239:22-240:6.

would suggest was considered in the Commission's rulemaking for 20 CSR 4240-10.085. In a more recent case the Commission revisited the idea of the acquisition premium and offered some insight as to the thought process leading to the rulemaking.

According to the Staff of the Missouri Public Service Commission, the Commission has not previously allowed recovery of an acquisition premium. Furthermore, the Commission does not want to encourage disreputable operators of small companies by allowing them to profit from the sale of a troubled system. But the Commission also understands the need for certainty on the part of the purchaser. The Commission recognizes that there may be circumstances that could warrant the encouragement of the purchase of a troubled system.⁹⁰

In that specific case the Commission did not grant an acquisition premium. However, it did clarify that acquisition premiums are not to be considered for recovery until a rate case.

The Commission's acceptance of Staff's recommendation for a debit acquisition premium for OUOC is not the only opportunity that the Commission will have to review OUOC's request and to determine the appropriate amounts to incorporate into rates.⁹¹ In the next general rate proceeding Staff and other parties will have an opportunity to examine the assets and further review OUOC's Asset Valuation Report to determine what amount is proper for rate base and the impact of the acquisition premium.⁹² Furthermore, OUOC has met each of the qualifications of 20 CSR 4240-10.085.

No one disputes that OUOC is a viable utility as that is term is defined in the rule, which operates several water and sewer utilities in Missouri and that it will not be materially impaired by acquisition of the OWC assets.⁹³ OUOC has proven through its affiliates that it maintains the necessary managerial, technical, and financial capabilities

⁹⁰ *In Re Missouri-Am. Water Co.*, No. WM-2004-0122, 2003 WL 23119952 (Dec. 18, 2003) (Clarifying report and order).

⁹¹ Tr. 278:17-279:1.

⁹² Ex. 102 Bolin Surrebuttal P. 3:3-11.

⁹³ Ex. 105C Dietrich Supplemental Schedule ND-d2 P. 19.

to operate the system(s) to be acquired.⁹⁴ Also, no one disputes that the OWC systems are nonviable utilities, which have been in receivership for 14 years.⁹⁵ The purchase price and financial terms of the acquisition are the same between OUOC and the Joint Bidders which evidences that they are fair and reasonable terms accomplished through a bankruptcy auction which can only be considered to have been reached through arm's length negotiations.⁹⁶ OUOC has committed to ensuring that any improvements necessary to make the OWC systems viable will be done in a reasonable time period.⁹⁷ OUOC along with physical improvements has also committed to ensuring that any managerial or operational deficiencies will be corrected within six months of acquisition, if possible.⁹⁸ OUOC has laid out in testimony how its planned improvements and changes will correct the OWC systems' deficiencies.⁹⁹ Staff has provided countless examples above that OUOC's acquisition of the OWC systems is in the public interest. Finally, OUOC has testified that the acquisition would be unlikely to occur without the probability of obtaining an acquisition incentive and Staff has not found evidence contrary.¹⁰⁰

Based on the elements an entity must meet to qualify under 20 CSR 4240-10.085, the evidence laid out above and the holding of the Western District in *AG Processing*, Staff finds that it is proper to award OUOC consideration for a debit acquisition premium in this matter.¹⁰¹ Staff supports that pursuant to *AG Processing* the Commission must consider the acquisition premium in conjunction with its determination that the acquisition is not detrimental to the public interest.¹⁰² However, the recently implemented Rule 20 CSR 4240-10.085 considers a specific delineated list of criteria in which an acquisition premium is proper and as Staff has outlined, OUOC has met each of those criteria.¹⁰³ The Commission can properly

⁹⁴ *Id.* at Pp. 32-33.

⁹⁵ *Id.* at P. 19.

⁹⁶ *Id.* at Pp. 9-14.

⁹⁷ Ex. 1 Cox Direct, Pp. 26-28.

⁹⁸ *Id.* at Pp. 6:21-7:22.

⁹⁹ Ex. 6 Thomas Direct, Pp. 12-23.

¹⁰⁰ Ex. 1 Cox Direct, Pp. 25:15-26:2.

¹⁰¹ Ex. 105C Dietrich Supplemental Schedule ND-d2, Pp. 23-24.

¹⁰² *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n of State of Missouri*, No. WD60631, 2003 WL 1906385, at *2 (Mo. Ct. App. Apr. 22, 2003), as modified (May 27, 2003).

¹⁰³ Ex. 105C Dietrich Supplemental Schedule ND-d2, Pp. 23-24.

consider the amount of the adjustment, the resulting impact on customer rates, and any additional factors in OUOC's first rate case.

Conclusion

There are many facts in this matter and many parties concerned about the future of the OWC systems. Only the Commission can determine what is proper and what will ensure safe and adequate water and sewer services for the current OWC customers. Staff recommends that the standard to be applied is “**not detrimental to the public interest**” after considering the technical, managerial and financial capacity of OUOC. It further proposes that OUOC has met the not detrimental to the public interest standard and has proven its affiliates have a history of providing safe and adequate services to their customers. Staff does not think that it is proper for the Commission to deny an application that meets the not detrimental to the public interest standard simply due to opposing parties' speculative proposals for which, appropriately, limited investigation or discovery has been conducted. Finally, Staff recommends that OUOC has met each of the elements of Commission rule 20 CSR 4240-10.085 and should be granted consideration of a debit acquisition premium in its first request for a rate increase. Staff appreciates the Commission's careful consideration of this issue and trusts that the Commission will find that Staff's recommendations are proper to ensure ongoing safe and adequate service for the customers of OWC.