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 Nos: WA-2019-0185 & SA-2019-0186

PUBLIC COUNSEL'S INITIAL POST-HEARING BRIEF

Respectfully submitted,

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I. Introduction

The Public Service Commission (Commission) is charged to act as a proxy for a free market in a world where utilities inevitably form natural monopolies. In a free market, the public's choice for a service provider would win out. The Osage Utility Operating Company (OUOC or Company), acting as an affiliate of Central States Water Resources (CSWR), however interjects itself as the better public provider. The OUOC is asking for the authority to acquire the Osage Water Company (OWC) water and sewer assets, and the Staff of the Public Service Commission (Staff) endorses OUOC's proposal without considering other options or checking the veracity of OUOC's need for an acquisition incentive. The actual public comes in the form of the Cedar Glen Condominium Owners Association (Cedar Glen) who asks that the Commission consider the alternative proposal of the Public Water Supply District #5 of Camden County, Missouri (PWSD #5), Lake Area Waste Water Association (LAWWA), and Missouri Water Association (MWA) (collectively Joint Bidders) for safe and adequate service at a more efficient cost. Cedar Glen residents provide over seventy public comments in favor of the Joint Bidders' proposal to have PWSD #5 be its service operator, amounting to nearly 17% of the OWC's total customer base and

close to a third of Cedar Glen itself.[1] The Office of the Public Counsel (OPC) echoes the concerns and requests of the affected public.

The OWC systems are composed for four water and sewer service areas at the Lake of the Ozarks: Cedar Glen, Chelsea Rose, Cimarron Bay, and Eagle Woods.[2] CSWR had previously attempted to acquire the OWC systems in 2015 and 2017,[3] but the OUOC only acquired its current interest in the OWC systems by outbidding other competitors at a bankruptcy auction on October 24, 2018.[4] Prior to the auction, CSWR negotiated with the bankruptcy trustee to be designated as the "stalking horse bidder."[5] As the stalking horse bidder, CSWR enjoyed the privilege of being "declared the high bidder" and win by default in the event that its bid matched a competing offer.[6] CSWR's initial offer to purchase the OWC systems was $465,000, and, following competing bids from both the Joint Bidders and Missouri American Water Company (MAWC), CSWR raised the purchase price with multiple bids until both the Joint Bidders and CSWR offered $800,000.[7] CSWR's stalking horse bid won over the Joint Bidders'.

CSWR then formed the OUOC holding company "for the purpose of purchasing and operating the OWC" systems.[8] OUOC filed its initial application in December 19, 2018, then modified on February 19, 2019.[9] OUOC is requesting for both a Certificate of Convenience and Necessity (CCN) to operate the OWC assets as well as an acquisition incentive for its procurement of the OWC. OUOC is specifically asking for both a rate of return premium and a debit acquisition

[1] Transcript of Proceedings, Evidentiary Hearing, WA-2019-0185 p. 69 (Sep. 17-18, 2019).
[2] *Amended Application and Motion for Waiver*, WA-2019-0185 (Feb. 19, 2019).
[3] Exhibit 100, *Direct Testimony of Natelle Dietrich*, WA-2019-0185 ND-d2 p. 10 (July 11, 2019).
[4] *Id.* at 12.
[5] *Id.* at 11.
[6] *Id.*
[7] *Id.* at 13.
[8] *Id.* at 19; *Amended Application and Motion for Waiver*, Appendix A.
[9] *Amended Application and Motion for Waiver*.

adjustment equal to the difference between OUOC's purchase price and OWC's rate base value.[10] The Commission granted the intervention of the Joint Bidders and Cedar Glen on January 29, 2019.[11]

Prior to OUOC's application, the Commission deemed the OWC assets abandoned in 2002 due to neglect and disrepair, and the Circuit Court of Camden County, Missouri later placed the assets into receivership in 2005 following a Commission petition.[12] The OWC assets have not met the requisite "safe and adequate" standard to serve its customers for at least 14 years. However, "not safe" does not equate to imminent harm as the prolonged status of receivership indicates. Evidence submitted by the Company itself states that the necessary repairs are "all cosmetic."[13] The cosmetic nature of OWC's distress thus provides the Commission with the opportunity to duly consider all available options to ensure no detriment to the public, rather than rush to judgment based on a superficial review of only one choice.

II. The Sale of Osage Water Company's Certificates of Convenience and Necessity and its Water and Sewer Assets to Osage Utility Operating Company Would be Detrimental to the Public Interest

The Commission should deny OUOC's requested approval of the sale of the OWC systems and associated CCNs to OUOC because the record does not sufficiently prove that the acquisition would not be detrimental to the public interest. To the contrary, approving OUOC's application forecloses other viable alternatives to service the public at a more efficient cost, and is therefore detrimental to the public interest.

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[10] Exhibit 1, *Direct Testimony of Josiah Cox*, WA-2019-0185 p. 24 (July 11, 2019).
[11] *Order Granting Interventions, Order Consolidating Cases, and Order Setting Prehearing Conference*, WA-2019-0185.
[12] Exhibit 100, ND-d2 p. 10.
[13] Exhibit 11.

A. Applicable Legal Standard

An acquisition of a public utility asset ultimately turns upon a "detriment to the public interest" standard. Specifically, the Commission may only approve the transfer or sale of regulated utility assets with a finding that such a transfer or sale is not detrimental to the public interest.[14]

The Commission has jurisdiction over the sale of the OWC assets due to the OWC originally obtaining a CCN to operate as a water corporation in 1989.[15] Statute provides that no water corporation shall "sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system . . . without having first secured from the commission an order authorizing it so to do."[16] Any transfer not in accordance with Section 393.190, RSMo "shall be void and of no effect."[17] The OPC initially notes that OUOC's application is inherently deficient in that the statute at issue contemplates the seller seeking approval, not the buyer. The OUOC failed to join the bankruptcy trustee or any other representative of the OWC in this proceeding, and instead attempts to insert itself as the "water corporation" seeking approval to sell itself the OWC assets. The OUOC's application thus fails to comply with the statute as written.

Regardless, assuming that OUOC's application is formalistically proper under Section 393.190, it substantively fails to meet the public interest standard at issue. Staff presents the transfer of CCNs as being judged under a review of whether the applicant has the technical, managerial, and financial (TMF) capacity to operate the assets, while believing that the creation of new CCNs is judged under a different standard of review following the form of the

[14] *State ex rel. St. Louis v. Pub. Serv. Comm'n*, 73 S.W.2d 393, 400 (Mo. 1934).
[15] Exhibit 100, ND-d2 p. 18.
[16] Mo. Rev. Stat. § 393.190 (2013).
[17] *Id.*

Commission's decision from *In Re Tartan Energy*.[18] Accordingly, a CCN applicant is judged on 1) the 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.[19]

However, whether a CCN is "new" when it is transferred to a different utility is largely a semantic point as a transferred CCN is ultimately new to the transferee. The TMF and Tartan factors are best thought of as frameworks for helping to determine whether there is a detriment to the public interest, rather than being superseding, distinctly different tests. Neither analysis is inherently dispositive in a CCN case. In fact, simply reviewing the TMF credentials of the applicant when evaluating a requested CCN transfer is insufficient to determine no detriment to the public interest.

Determining that there is no harm to the public interest requires reviewing the public interest itself. There is no detriment to the public interest when safe and adequate service is provided at just and reasonable rates. Just and reasonable rates are only those rates necessary to secure safe and adequate service along with a fair opportunity to earn a return for the utility.[20] Therefore, determining that there is no detriment to the public interest necessarily requires evaluating what is absolutely necessary to provide safe and adequate service, and how rates are to be kept just and reasonable. A public interest review may also include a multitude of ancillary factors such as the voice of the public, the impacts of approving the applicant's proposal, alternative proposals, and future ratemaking implications. Reviewing the public interest in this manner is consistent with Missouri case law and Commission practice.

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[18] Exhibit 105, *Supplemental Testimony of Natelle Dietrich*, WA-2019-0185 Revised Recommendation p. 20 (Sep. 13, 2019).
[19] *Report and Order*, GA-94-127 p. 6 (Sep. 16, 1994).
[20] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Water Works & Improv. Co. v. PSC of W. Va.*, 262 U.S. 679, 692-93 (1923).

This Commission has historically weighed alternative options of serving the public when they are argued by intervenors. The Commission's review of previous electric utility CCNs has required a systematic review of competing evidence rather than a narrow view of simply the applicant's position.[21] This review also gives "due consideration" to the wishes of the public being served, and future service possibilities depending on which competing proposal is approved.[22]

In *State ex rel. Intercon Gas, Inc. v. Public Service Commission*, the Commission considered alternative operators of an intrastate natural gas pipeline.[23] On appeal, Missouri's Western Appellate Court affirmed the Commission's consideration of competing offers and ultimate selection of how the public would "best be served."[24] The Commission later relied upon the *Intercon* analysis when deciding *In Re Tartan Energy*.[25]

In other proceedings, this Commission has even relied upon purely hypothetical transactions that "could" serve the public interest better than actual proposals.[26] When Aquila sought to join the Midwest Independent Service Operator network, the Commission determined that the public interest would be deterred because, "in part, because Aquila's plan to join Midwest ISO would preclude it from joining Southwest Power Pool . . . the net benefit to Aquila of joining

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[21] *See, e.g., In the Matter of the Application of Arkansas-Missouri Power Company for a Certificate of Convenience and Necessity to Construct a 3-Phase, 33,000 Volt Transmission Line in Ripley County, Missouri, Report and Order*, 1947 Mo. PSC LEXIS 30, 12-13 (Nov. 24, 1947) ("We are not convinced by evidence that either protestant is able to perform the service desired by the pipe line company").

[22] *See, State ex rel. Kan. City Power & Light Co. v. Pub. Serv. Comm'n*, 76 S.W.2d 343, 354 (Mo. 1934) (Doubtless, under the circumstances, the interest and preference of the consumer was of some weight . . ."); *see also e.g., Report and Order,* Application of The Gas Service Company for a Certificate of Convenience and Necessity to Serve as a Natural Gas Public Utility a Described Area in Platte County, Missouri.; Application of Missouri Public Service Company for a Certificate of Convenience and Necessity for Ownership, Operation and Maintenance of a Natural Gas Distribution System and All Connecting Lines Required Therewith Within Platte County, Missouri, 1955 Mo. PSC LEXIS 20, 18-19 (While the preference of the city [of Kansas City] and the prior filing by Gas Service would not be of such weight as to control our decision, we do finding that under all of the facts and circumstances as shown by the evidence, such factors should be given due consideration").

[23] *See* 848 S.W.2d 593, 595-596 (Mo. App. W.D. 1993) (describing how the Commission considered the competing offers of Intercon, Missouri Gas Company, Missouri Pipeline Company, and Laclede Gas).

[24] *Id.* at 596.

[25] *Report and Order*, GA-94-127 p. 6 (Sep. 16, 1994).

[26] *Report and Order*, EO-2008-0046 p. 17 (Oct. 9, 2008).

Midwest ISO would be approximately $65 million less over ten years than the net benefit it could obtain by Southwest Power Pool."[27]

This Commission has even previously entertained arguments from other potential buyers when previously considering the OWC assets.[28] The *Environmental Industries v. Public Service Commission* Court upheld the Commission's denial of an acquisition proposal that failed to include the Cedar Glen portion of the OWC. Including Cedar Glen was important to the Commission because of "the potential for a *dramatic rate increase* for customers absorbed by MAWC and the stranding of the Cedar Glen customers with a distressed utility led the Commission to conclude the Application was detrimental to the public interest."[29] Therefore, the Commission can again consider future rate increases when judging another proposed acquisition of the OWC on a public interest standard.

B. It is Detrimental to the Public Interest to Foreclose Other Viable Water Provider Options for the Public When Those Other Options Can Provide the Same Safe and Adequate Service at a more Efficient Cost.

The OUOC's application is detrimental to the public interest because it forecloses other potential operators who can provide safe and adequate service at a more efficient cost. A CCN sanctions monopoly power to one utility, excluding all other alternatives. The foreclosure of alternatives supports the public interest when it prevents duplicative services and undesirable competition.[30] A CCN approval is conversely detrimental to the public interest when other viable service options are foreclosed in favor of providing monopoly privileges to a company seeking to

[27] *Id.*
[28] *See Evntl. Utils. v. Pub. Serv. Comm'n*, 219 S.W.3d 256, 260 fn3 (Mo. App. W.D. 2007) (noting Cedar Glen Condominium Owners Association's competing interest against Missouri American Water's proposed purchase of the OWC assets).
[29] *Id.* at 263 (emphasis added).
[30] *State ex re. Intercon Gas*, 848 S.W.2d at 597.

charge customers beyond that which is necessary to provide safe and adequate service. Although a CCN case is doctrinally not ratemaking, approving a CCN does come with practical implications as to future rate increases and the trajectory of approved expenses. OPC witness Keri Roth explained at the evidentiary hearing that it is "not very often" than expenses approved in a CCN case are later disallowed in a rate case.[31] Therefore, to determine whether OUOC's proposal is detrimental to the public interest, one must consider the alternative presented by Cedar Glen and the Joint Bidders.

The OUOC proposes to acquire the OWC systems and to remedy its current environmental deficiencies with at least $2,083,475 in total repairs.[32] Since utility customers are expected to pay for a return on and of those investments incurred to provide safe and adequate service, repair costs beyond that which is necessary for safe and adequate service are necessarily detrimental to the public. Evidence in the record indicates OUOC's estimates are likely inflated.

As previously mentioned, OUOC's own evidence testifies to Cedar Glen's current operator, Jim "the Bear," believing the repairs necessary to be largely "cosmetic, building repairs, paint, cleaning the interior of the well house."[33] In the face of these superficial repair needs, OUOC witness Todd Thomas suggests $377,750 is needed. [34] Meanwhile, the actual residents of Cedar Glen believe that a little over a tenth of Mr. Thomas' estimate is necessary to address those cosmetic repairs.[35] This difference is one reason among many that Ms. Roth relied upon

[31] Transcript p. 327.
[32] Exhibit 6, *Direct Testimony of Todd Thomas*, WA-2019-0185 p. 7-23 (July 11, 2019).
[33] The Company presented several pages of PWSD #5 meeting minutes, with one meeting dated October 9, 2018, referring to a report from an individual named "Jim" regarding the repairs necessary to rehabilitate the Cedar Glen system. Jim's relation to Cedar Glen was only ascertained followed OPC questioning of Joint Bidders witness Neddie Goss. Exhibit 11; Transcript p. 444.
[34] Exhibit 6, p. 15-18.
[35] Exhibit 302, *Rebuttal Testimony of Kenneth Hulett*, WA-2019-0185 p. 6-7 (Aug. 13, 2019).

Reflections Subdivision Master Association, Inc. witness Anthony Soukenik's conclusion that OUOC "would not provide the least cost, capable utility service."[36]

Why OUOC's estimates diverge so vastly from the actual operator and local populace is not exactly clear. The lower cost estimates corroborates Ms. Roth's observation that despite the OWC systems being in receivership for over a decade, there has been no apparent public health scare or imminent harm for current OWC customers that would necessitate extreme repairs.[37] Staff witness Natelle Dietrich explains that Staff "did not review" OUOC's repair estimates, and so Staff has no input on point.[38] Staff's first and revised Recommendation similarly did not consider other potential operators when it concluded that transferring the CCNs to OUOC was not detrimental to the public interest.[39] When questioned by the Commission's Chair, Staff witness David Roos all but acknowledged that he had not done an independent review of other potential operators for the OWC systems, and that he could not speak to which option would be better for the public.[40]

One can speculate that OUOC has a vested interest in spending as much as possible to increase rate base, but regardless what is evident is that such a discrepancy will materially impact future rates and should therefore be considered now in accordance with *Environmental Industries*.[41]

The history of other CSWR affiliates also indicates that OWC customer rates will be significantly higher under OUOC's management than the Joint Bidders for no measurable benefit. To finance the necessary improvements to the Hillcrest water and sewer systems, CSWR sought

[36] Exhibit 203, *Surrebuttal Testimony of Keri Roth*, WA-2019-0185 p.4 (Sep. 4, 2019) (quoting *Rebuttal Testimony of Anthony J. Soukenik*, WA-2018-0185 p. 4 (Aug. 13, 2019)).
[37] Transcript p. 319
[38] Transcript p. 213.
[39] Exhibit 201; Transcript p. 227.
[40] OPC uses the phrase "all but acknowledged" specifically because Mr. Roos noticeably evaded the questions from Chair Ryan Silvey until the Chair relented in asking further questions. Transcript p. 251-53.
[41] 219 S.W.3d at 263.

approval of a financing agreement with a cost of debt of 14%.[42] In the 2017 Indian Hills rate case, the applicable CSWR affiliate asked the Commission to again approve a 14% cost of debt.[43] This Commission noted that "Indian Hills' cost of debt is significantly above market cost for a distressed public utility. Indian Hills' cost of debt is the result of dealings among entities closely inter-related with Indian Hills through chains of common ownership on both sides of the transaction."[44]

On the other hand, the Joint Bidders do not have an inflated cost of debt due to self-dealing. Instead, the Joint Bidders are proposing to purchase the OWC assets at the same price as OUOC, without an acquisition incentive, and to undergo necessary repairs with bond financing at 3.5% per annum interest.[45] This bond financing will enable OWC's customer rates to remain the same as they currently are despite the Joint Bidders' $800,000 purchase price.[46] If the Commission approves OUOC's CCN request with Staff's conditions then OUOC will return to the Commission within 24 months to initiate a rate case where rates will invariably rise just as they did in the Indian Hills and Hillcrest rate cases.[47] The high likelihood of OWC's rates exponentially increasing deserves special attention here because of Staff Counsel's repeated mistaken belief at the evidentiary hearing that Staff's Recommendation was for a rate increase moratorium to be instituted for 24 months. [48] Staff made no such recommendation, and this Commission should not operate under the same incorrect understanding. OUOC witness Josiah Cox's testimony openly states his opinion that OWC rates will have to be adjusted because they do not "reflect the current

[42] *Report and Order*, WR-2016-0064 p. 23 (July 12, 2016).
[43] *Report and Order*, WR-2017-0259 p. 53 (Feb. 7, 2018).
[44] *Id.* at 50.
[45] Exhibit 400, *Direct Testimony of David Stone*, WA-2019-0185 p. 5 (July 11, 2019).
[46] Transcript p. 385.
[47] Exhibit 105, Revised Memorandum p. 3.
[48] Transcript p. 33 & 457-58

cost of providing service."[49] There is then no question whether OUOC will seek to raise rates, only one of extent.

The OWC customers' rates will also likely be higher under OUOC's management than the Joint Bidders with no noticeable benefits because of OUOC's requested acquisition incentive. If granted, the acquisition premium will represent additional earnings that OWC's customers will pay the Company for the same safe and adequate service. Paying more for the same service is de facto a detriment to the public interest. Although this Commission may consider not approving a specific number for the acquisition premium, that conclusion will still require the Commission to consider the premium "as part of the cost analysis when evaluating whether the proposed [acquisition] would be detrimental to the public."[50]

Given CSWR's history of seeking high costs of debt, OUOC's significant repair estimates for cosmetic repairs, and OUOC's requested acquisition incentive, the record indicates that OUOC will not provide the least cost option for safe and adequate service. Therefore its acquisition is necessarily detrimental to the public interest. The Commission should instead entertain the alternative proposal brought by the Joint Bidders with lower rates, while still ensuring necessary repairs are made. This alternative is sponsored by the actual affected public, and provides a path towards safe and adequate service for the OWC under non-profit ownership.[51] The Joint Bidders are currently providing safe and adequate service in the Lake of the Ozarks area, and have demonstrated their ability to obtain environmental code compliance.[52] Not only does Staff's

[49] Exhibit 1, p. 23.
[50] *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n*, 120 S.W.3d 732, 736 (Mo. 2003).
[51] *See* Exhibit 300, *Direct Testimony of David G. Krehbiel*, WA-2019-0185 p. 2 (July 11, 2019).
[52] Exhibit 404; Exhibit 405; Exhibit 407.

Recommendation and testimony not rebut the Joint Bidders, Staff did not even send data requests to the Joint Bidders to determine if they could also provide safe and adequate service.[53]

The only party doubting the Joint Bidders' ability to provide safe and adequate service is OUOC. OUOC witness Mr. Thomas sponsored over 1,000 pages of schedules that he asserted all relate or demonstrate Joint Bidders' unfitness to provide safe and adequate service.[54] However, Mr. Thomas admitted at the evidentiary hearing that, despite the dearth of paper presented, he only provided the Commission with a "small sampling of a very large stack of information" from Missouri's Department of Natural Resources (DNR).[55] That is to say OUOC presented an admittedly incomplete view of the Joint Bidders' ability to provide safe and adequate service.

What OUOC did provide was not as incriminating as they claimed. Mr. Thomas claims in his surrebuttal that just one schedule, TT-S1 shows thirteen notices of violations from DNR to the Joint Bidders.[56] However, when questioned by OPC, Mr. Thomas was unable to identify a single page within TT-S1 that identifies a violation by Joint Bidders.[57] Instead he simply maintained "they're in there." Of course, a cursory review of TT-S1 demonstrates that the majority of it is composed of irrelevant letters from DNR approving requested extensions, issued permits, rule citations, advertisements for water quality inspection services, and other miscellaneous documents.[58] Of those effluent limit violations that Mr. Thomas claim exist within his schedule, there is no evidence that they actually resulted in a significant risk or harm to the public health or environment.

[53] Transcript p. 256.
[54] *See generally* Exhibit 7, *Surrebuttal Testimony of Todd Thomas*, WA-2019-0185 (Sep. 4, 2019).
[55] Transcript p. 175.
[56] Exhibit 7, p. 4.
[57] Transcript p. 181.
[58] Exhibit 7, TT-S1; *see also* Transcript p. 179-81.

Likewise, there is insufficient basis to conclude from the paperwork violations identified in Mr. Thomas' TT-S6 that the Joint Bidders cannot provide safe and adequate service.[59] Especially when one such paperwork violation was a failure by MWA to inform DNR before improving its own system.[60] The violations recounted in TT-S7 for Molokai Point and Minnow Brook are largely irrelevant since they were dated before those subject systems were acquired by the LAWWA and MWA.[61] Similarly, the potential[62] violation noted in TT-S9 has no bearing upon the Joint Bidders ability to provide safe and adequate service. TT-S9 is a positive sample result for total coliform within the Brentwood Condominiums water system.[63] Brentwood Condominiums is not a member of the MWA. LAWWA is the owner of the wastewater treatment plant for Brentwood, but not the drinking water system at issue.[64] After OPC asked Mr. Thomas about these aforementioned schedules, he agreed that most of his documents do not show environmental or health violations.[65] The record in sum simply does not leave the Commission with enough to dismiss the Joint Bidders as functional service providers.

III. The Commission Should Not Approve an Acquisition Premium for the Acquisition of the Osage Water Company under 20 CSR 4240-10.085.

The Commission should not approve an acquisition premium under 20 CSR 4240-10.085 for OUOC's purchase of the OWC systems because the Company has failed to satisfy the

[59] Although Mr. Thomas repeatedly tried to avoid answering the question, he ultimately admitted that completing applications and filing engineering reports are "paperwork." Transcript p. 186.
[60] Exhibit 7, TT-S6; Transcript p. 185.
[61] Transcript p. 428.
[62] OPC uses the word "potential" here because the comments provided in the sample indicate incredulity on the part of the reviewer. The reviewer stated that despite the June 2019 positive total coliform results, "I [the reviewer] checked their history for the past year and saw only safe samples. I will call Josh Lee tomorrow to see what is going on with the system to cause the positive samples." Based on the uncertainty in why the samples were positive for total coliform, the OPC wonders whether there was a sampling error. Exhibit 7, TT-S9.
[63] *Id.*
[64] Transcript p. 421.
[65] Transcript p. 187.

necessary elements of the rule. Namely, OUOC fails to demonstrate that the acquisition is in the public interest and that the acquisition is unlikely to occur but for the probability of the incentive. Furthermore, there is insufficient legal basis for the rule. Any acquisition premium originating from the rule is therefore unlawful.

A. Applicable Legal Standard

This Commission may only implement rules under authority delegated to the Commission by the Missouri Legislature, and when those rules comply with Chapter 536.[66] Chapter 536 dictates the procedural requirements for creating an administrative rule, but also provides that even a fully implemented rule can be invalid if there is a lack of statutory authority supporting the rule "or any portion thereof," if the rule conflicts with state law, or if the rule is "so arbitrary and capricious as to create such substantial inequity as to be unreasonably burdensome on persons affected."[67]

The acquisition incentive rule itself provides that the "acquiring utility has the burden of proof and shall demonstrate" that the acquisition is in the public interest, and that the acquisition is "unlikely to occur without the probability of obtaining an acquisition incentive."[68]

B. The Commission Should Deny the Request for an Acquisition Incentive Because the Evidence in the Record Clearly Demonstrates that the Acquisition of the Osage Water Company Would Occur Without an Acquisition Premium.

The OUOC fails to carry its burden to receive an incentive under the rule. To receive a requested incentive, the OUOC must demonstrate that the acquisition is in the public interest, and that the acquisition would be unlikely to occur but for acquisition incentive.[69] Similar to why approving OUOC's requested CCN is detrimental to the public interest, foreclosing more efficient

[66] Mo. Rev. Stat. § 386.125 (2005).
[67] Mo. Rev. Stat. § 536.014 (1997).
[68] 20 CSR 4240-10.085(4).
[69] 20 CSR 4240-10.085(4).

means of achieving safe and adequate service is not in the public interest. The OUOC fails to show that it is the only path forward for the OWC customers. The OPC refers to the arguments already made as to public interest rather than belaboring this point further.

As for the probability of the transaction occurring, the Joint Bidders have shown their willingness to purchase the OWC systems without an acquisition incentive, and their current provision of water and sewer services to their existing constituency speaks to their ability to service the OWC systems. The Joint bidders also have a currently valid contract to purchase the OWC systems, without an acquisition incentive provided that OUOC's application is denied.[70] They even extended the contract beyond the closing date in order to comport with this ongoing proceeding.[71] MAWC also offered to purchase the OWC systems for less than what OUOC bid.[72] OUOC originally offered to buy the OWC systems for less with its opening bid. The acquisition itself is then likely to occur without the probability of obtaining an acquisition incentive.

One could take the semantic argument that rule's use of "the acquisition" refers not to whether the OWC would have been purchased by anyone else, but instead whether the OUOC would be unlikely to purchase the OWC systems without an incentive. Even under this narrow lens though, the record's evidence displays the OUOC's eagerness to purchase the OWC regardless of any incentive. Years before the OUOC initiated this docket, CSWR previously tried to purchase the OWC in 2015 and 2017, with the 2017 offering bid even being less than the 2015 version.[73] In its latest attempt to purchase the OWC, not only did CSWR negotiate its position as the "stalking horse purchaser" so that any matching bid it offered would win by default during the

[70] Transcript p. 74-76.
[71] Transcript p. 76.
[72] Exhibit 100, ND-d2 p. 13.
[73] Exhibit 202, *Rebuttal Testimony of Keri Roth*, WA-2019-0185 p. 12 (Aug. 13, 2019); Exhibit 100, ND-d2 p. 10-11; Transcript p. 120.

auction for the OWC systems, CSWR repeatedly raised its bid offer by "match[ing] each offer by the Joint Bidders until the Joint Bidders failed to make a competing higher offer."[74] This behavior resulted in the original bid offer rising from $465,000 to nearly double at $800,000.[75] Nearly doubling the purchase prices is the behavior of a company doggedly chasing an asset regardless of an additional incentive.

Bear in the mind that all of CSWR's bids from 2015 to 2018, and other actions undertaken to secure the OWC systems, occurred before the acquisition incentive rule was even in effect. The acquisition incentive rule only became available January 30, 2019.[76] Since OUOC's acquisition occurred before the incentive was even available, by definition the acquisition occurred without the probability of obtaining the incentive.

The OUOC's tenacity towards Reflections also fails to comport with the behavior of a passive investor who would not be here but for an incentive. The OUOC originally included a neighboring water and sewer system, Reflections, in its application. However, the Great Southern Bank sold Reflections to a third party during the pendency of this case.[77] CSWR and OUOC have since initiated a legal action to compel the unwilling Bank to sell the Reflections Systems.[78] None of this behavior follows the modus operandi of a passive applicant who needs an acquisition incentive. Of course, none of the OUOC's behavior is particularly surprising though when one considers that CSWR's business model is to acquire, rehabilitate, and operate distressed water system.

[74] *Staff Recommendation*, WA-2019-0185 Attachment A p. 5 (May 24, 2019).
[75] *Id.*
[76] 20 CSR 4240-10.085.
[77] *Motion to Dismiss or, in the Alternative, Motion to Modify Osage Utility Operating Company, Inc's Amended Application*, WA-2019-0185 (Sep. 6, 2019).
[78] *Cent. States Water Res., Inc. v. Great S. Bank et al.*, 19CM-CC00158.

As Counsel for OUOC recounted at the evidentiary hearing, CSWR and its affiliates have already acquired twenty-two Missouri based "wastewater treatment plants with associated facilities."[79] Ms. Roth's testimony speaks directly to this point as she discovered the extent of CSWR's interstate reach in its pursuit to acquire more water and sewer systems. She explains in rebuttal that Mr. Cox has testified to the Tennessee Public Service Commission that his business plan is to "acquire and recapitalize failing systems."[80] Mr. Cox went on to state that a new investor "is allowing CSWR *to form companies for the purpose of acquiring distressed water and wastewater systems* in additional states including Tennessee."[81] Ms. Roth also found the Company making similar statements to the Kentucky Public Service Commission. CSWR told the Kentucky Commission that it operates by forming "affiliates for the purpose of acquiring and professionalizing distressed water or wastewater systems."[82] Again in Louisiana, CSWR's application described itself as having the "business plan" to "pursue the purchase and recapitalization of small water and wastewater systems, many of which are financially distressed."[83] According to Ms. Roth's research, CSWR is operating in this manner in at least five states all without using an acquisition incentive previously: Missouri, Arkansas, Kentucky, Tennessee, and Louisiana.[84]

This pattern of continual expansion and acquisition proves that CSWR and its affiliates operate under an express business model of buying and rehabilitating water and wastewater systems. The pattern also proves that it has operated under this model without additional acquisition incentives, and will more than likely do so in the future. It is highly likely that OUOC

[79] Transcript p. 22.
[80] Exhibit 202, p. 9.
[81] *Id.* (emphasis added).
[82] *Id.* at 10.
[83] *Id.* at 10-11.
[84] *Id.* at 11.

would acquire the OWC systems without an acquisition incentive precisely because CSWR has the same profit incentive to acquire the OWC as it did regarding the other nearly two hundred systems it has acquired or is currently seeking.[85] Mr. Cox admitted that that there is inherent economic value in CSWR "establishing a presence in the Lake of the Ozarks"[86] and even joked that he would "like to buy Public Water Supply District No. 5."[87] OUOC has every incentive by the nature of CSWR's business model to acquire the OWC, and every incentive to seek more money in the form of an acquisition premium.

The evidence that the acquisition is likely to occur without the probability of an incentive vastly outweighs OUOC's evidence to the contrary. What is that contrary evidence in the record? Mr. Cox's word and nothing more. Staff Counsel claims that no one can know whether the OWC systems would have been bought without an incentive because "there's no way to know what might have happened in an alternate universe."[88] Despite this doubt, Staff Counsel justifies its recommendation in favor of an acquisition incentive based solely "on the statement of Josiah Cox that absent approval of an acquisition premium his company would need to reevaluate its position on purchasing the systems."[89] As Staff witness Kim Bolin explained her testimony at the evidentiary hearing, "the only thing we have right now to use" in the record is Mr. Cox's assertion that OUOC might not buy the OWC systems but for an added incentive.[90] Likewise, Ms. Dietrich recommends that OUOC receive an acquisition incentive on the basis of Mr. Cox's word despite having "no way to independently verifying that though."[91] As she states, "Staff accepted Mr. Cox's

[85] Exhibit 1, p. 6.
[86] Transcript p. 144-45.
[87] Transcript p. 152.
[88] Transcript p. 35.
[89] Transcript p. 36.
[90] Transcript p. 266.
[91] Transcript p. 219.

statement,"[92] presumably because she does not believe that the "the rule requires Staff to make that finding" as to whether the acquisition is likely to occur without an acquisition incentive.[93] One wonders then why Staff is recommending the Commission approve an acquisition incentive when they simultaneously do not believe that OUOC met a necessary element of the incentive. [94]

"Josiah Cox says so" is not a good enough standard to serve the public. It is not good enough to determine whether the applicant OUOC has met its burden of proof to show that the acquisition would not occur but for the incentive. It is not good enough to conclude that the acquisition incentive is in the public interest. It certainly is not good enough to establish confidence in OUOC's position given that CSWR and its President Mr. Cox have a vested interest in continually expanding operations.

Mr. Cox claims that CSWR may have to rethink its business model if it does not receive a new incentive, but his credibility on this point is undermined by his inconsistent statements at the evidentiary hearing. When questioned by Counsel for the Joint Bidders, Mr. Cox expressed ignorance on an inconsequential matter:

Q. When did that operating company acquire Elm Hills? Do you recall?

A. I don't remember, sir.

Q. Was it less than two years ago?

A. I don't remember.[95]

However, Mr. Cox's memory was seemingly restored once he was crossed by an attorney friendly to his position without the need for a break or for his own Counsel to approach:

[92] Transcript p. 238.
[93] Transcript p. 219.
[94] *See* Exhibit 200.
[95] Transcript p. 115.

Q. And I think you answered that there hasn't been any [sic] rate increases at Elm Hills since CSWR has owned those properties, correct?

A. That is correct.

Q. And do you have notes that would indicate when at least some of those properties were purchased?

A. When we purchased the properties?

Q. Yes.

A. Yes, we purchased the initial systems Missouri Utilities which was another Missouri receivership system and State Park Village which was an unregulated sewer district in October of '17.[96]

Given this inconsistency, additional costs should not be imposed on customers in the form of an acquisition incentive based on the Company's word alone.

Furthermore, as Staff Counsel herself stated, "I think [the OWC systems are] worth whatever a company is willing to buy them for."[97] OUOC was willing to pay more and more for the OWC systems to make the auction close at $800,000. Why then, should Missouri's customers pay more to incentivize an acquisition when the systems servicing them are so valuable that competing parties will place multiple bids up to nearly $1 million to acquire them? The answer is that there is no justification for the incentive, and that OUOC fails to prove that the acquisition is not likely to occur without its requested acquisition premium.

[96] Transcript p. 149.
[97] Transcript p. 38.

C. There is Insufficient Legal Authority to Grant an Acquisition Premium as Contemplated under 20 CSR 4240-10.085, and What Authority Exists Contradicts the Rule.

Beyond simply not meeting the threshold requirements of the rule, the Commission should also deny OUOC's requested acquisition incentive because there is insufficient legal authority for the rule itself. The acquisition incentive rule provides that applicants acquiring nonviable water or sewer utilities may receive a "rate of return premium" in the form of an additional "one hundred (100) basis points, applied to either the acquiring utilities entire rate base or to the newly acquired rate base," or a "debit acquisition adjustment" in the form of a lump sum that is added to the acquiring utility's rate base to reflect the extra acquisition cost of the acquired non-viable utility.[98] Regardless of the form, either acquisition incentive represents isolated ratemaking treatment outside of a rate case. Single issue ratemaking is generally disallowed, and is only permitted when expressly provided by statute.[99]

The acquisition incentive rule relies upon Sections 386.040, 386.250, and 393.140, RSMo for its existential authority.[100] None of those statutes grant the Commission the authority to enact an acquisition premium program for water and sewer systems or any other utility. Section 386.040 establishes the Commission and guarantees that it shall be vested with all powers "necessary or proper" to effectuate the powers and duties of Chapter 386.[101] No other statute in Chapter 386 speaks to an acquisition incentive, and Section 386.040 says nothing further on point. Section 386.250 provides the Commission's jurisdiction and establishes its authority to regulate the rates charged by various utility corporations. The jurisdictional statute says nothing as to acquisition

[98] 20 CSR 4240-10.085(1).
[99] *See* Mo. Rev. Stat. § 393.270 (1967) (calling for the consideration of all relevant factors when setting rates).
[100] 20 CSR 4240-10.085.
[101] Mo. Rev. Stat. § 386.040 (1939).

incentives.[102] Section 393.140 enumerates certain general powers of the Commission. None of those powers speak to authorizing the Commission to grant acquisition incentives.[103] Any assertion of legality is thus extra-textual and is founded on implication.

However, any inference to engage in single issue ratemaking or extra-textual mechanisms is highly disfavored. Missouri Courts narrowly interpret this Commission's power to use and create rate mechanisms.[104] Without express statutory authority, the acquisition incentive rule is foundationless and unlawful.

The statutory authority that is available actually bars the acquisition incentive as envisioned by the rule. The only statute on point, Section 393.146, RSMo, permits a rate of return adjustment of one hundred basis points, not a debit acquisition adjustment, but only following the compelled purchase of a failing water system.[105] The State Legislature did not envision a permissive program where capable utilities are incentivized to acquire failing water and sewer system, but a commanding program where utilities are simply ordered to acquire distressed systems. The Legislature also drafted the statute imagining that the acquiring utility will be a larger entity serving at least 8,000 customers.[106] The OUOC does not meet the 8,000 customer threshold, but otherwise enjoys the benefits of the contested rule.

Section 393.146 also requires the Commission to consider practical and economically feasible alternatives.[107] The acquisition rule does not incorporate this consideration, and in fact the

[102] Mo. Rev. Stat. § 386.250 (1996).
[103] *See* Mo. Rev. Stat. § 393.140 (1967).
[104] *See Verified Application & Petition of Liberty Energy (Midstates) Corp. v. Office of Pub. Counsel*, 464 S.W.3d 520, 525 (Mo. 2015) (overruling a Commission Order that used an expansive view of the word "deteriorate" within the infrastructure system replacement surcharge statute); *see also State ex. rel. Util. Consumers Council v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 47 (Mo. 1979) (denying the Commission's creation of a fuel adjustment clause without an express authorizing statute).
[105] Mo. Rev. Stat. § 393.146 (2005).
[106] Mo. Rev. Stat. § 393.146.1(1).
[107] Mo. Rev. Stat. § 393.146.3.

Company has actively attempted to curtail the Commission's scope of inquiry as it asks for more money on top of that necessary to operate the OWC systems.[108] Section 393.146 also attempts to limit the impact to ratepayers by preventing the acquiring utility from earning a rate of return on the portion of the purchase price in the excess of the distressed system's rate base value.[109] The rule has no apparent limit to its debit acquisition adjustment, and seemingly would allow an applicant utility to raise a purchase price ad infinitum so long as it later claims that it would not buy the failing utility but for the incentive. The acquisition incentive rule thus represents a contravention of state law, and otherwise lacks statutory authority.

D. The Acquisition Premium Rule is so Arbitrary and Capricious as to Create Such a Substantial Inequity to the Public.

Beyond lacking statutory support and contradicting other provisions of law, the acquisition rule is also arbitrary and capricious as to create a substantial inequity to the public. During the evidentiary hearing Commissioner Scott Rupp posited that perhaps the Company continually "wanted to match the bid . . . due to the opportunity to help recoup their cost" through the acquisition incentive.[110] This explanation actually reveals the acquisition incentive's arbitrary nature, and explains why the rule is bad public policy. If indeed the promise of an incentive enticed the Company to continually bid up the price of the OWC at the bankruptcy auction, then a debit acquisition adjustment under the rule can likewise over inflate purchase prices. A for-profit acquiring utility will always seek more of an incentive, especially if the difference in book value and acquisition prices is borne by the ratepayers. Without a counter-incentive to get a company to stop raising its offering price, and the promise of customers shouldering the excess acquisition cost

[108] *See Amended Motion to Strike and/or Limit Scope of Proceeding*, WA-2019-0185 (Sep. 9, 2019).
[109] Mo. Rev. Stat. § 393.146.7.
[110] Transcript p. 275.

through a premium, the customers of failing water and sewer systems are imperiled to pay ever rising acquisition costs for no added benefit.[111]

The rule effectively places customers of certain failing water and sewer systems in inequity relative to other customers. The rule arbitrarily and capriciously adds to customer obligations than what would otherwise be required to obtain safe and adequate service. The danger of utilities being incentivized to raise their purchase bids is probably why the Legislature drafted a statute on point that compelled sales, rather than accepted applications, and limited rate of return premiums to the actual rate base value of the acquired entity.[112]

IV. Conclusion

The OUOC's requested CCN is detrimental to the public interest because it forecloses other, economically feasible alternatives to reach safe and adequate service. Cedar Glen voices its preference to not be served by the OUOC, and the Joint Bidders present this Commission with a viable alternative. The OPC asks that this Commission consider that option before sanctioning a monopoly right to OUOC. A denial here is not a non-answer, but a better answer than the repair estimates and added incentive offered by the Company. We need not be so desperate as to simply approve the first applicant. This Commission can and should methodically consider the options presented to it, and what future implications will be borne by ratepayers depending on the option taken.

Similarly, the OUOC should not be granted an acquisition incentive because it fails to demonstrate that the acquisition is in the public interest, and because the acquisition would be

[111] *See* 20 CSR 4240-10.085(1)(B) (defining that the debit acquisition adjustment as the excess acquisition price over the purchased system's depreciated original cost).
[112] *See* Mo. Rev. Stat. § 393.146.7.

highly likely to occur without an incentive. Furthermore, the rule itself is not properly supported by law.

WHEREFORE, the OPC requests that the Commission deny both the Company's CCN application and requested acquisition incentive.

Respectfully,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this 3rd day of October, 2019, with notice of the same being sent to all counsel of record.

/s/ Caleb Hall