

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

In the Matter of the Application of Missouri-American )  
Water Company for a Certificate of Convenience and )  
Necessity Authorizing it to Install, Own, Acquire, )  
Construct, Operate, Control, Manage and Maintain a )  
Water System and Sewer System in and Around the )  
City of Eureka, Missouri )

**Case No. WA-2021-0376**

**STAFF’S INITIAL POST-HEARING BRIEF**

**COMES NOW** Staff of the Missouri Public Service Commission (Staff), through counsel, and files *Staff’s Initial Post-Hearing Brief*.

**FACTUAL AND PROCEDURAL BACKGROUND**

Missouri-American Water Company (MAWC) filed an application on April 26, 2021 seeking Commission permission and a Certificate of Convenience and Necessity (CNN) to own and operate the water and sewer systems currently owned by the City of Eureka (Eureka). MAWC proposes to purchase the Eureka systems pursuant to the appraisal statute, §393.320, RSMo. This is not the first time MAWC has purchased small utilities using the appraisal statute, but this is the Commission’s first opportunity to substantively consider its parameters. This law establishes a process for determining the systems’ appraised value, which becomes the systems’ rate base if the Commission approves the transaction. Consistent with the second – and higher – appraisal MAWC received, MAWC proposes to purchase the water system for approximately \$18 million, and the sewer system for approximately \$10 million, for a total of approximately \$28 million.

Each system serves approximately 4,000 customers in Eureka. According to Missouri Department of Natural Resources (DNR) records, the water system is in

compliance with DNR's regulatory requirements.<sup>1</sup> But because of water aesthetic issues, MAWC intends to use the system's six wells and treatment facility as only emergency back-up and construct a pipe from St. Louis to service Eureka residents. Although Staff does not characterize the sewer system as a troubled system, it is ailing due to lack of maintenance. It has not been in DNR compliance for at least five years, because it fails to meet permit effluent limitations for biochemical oxygen demand and total suspended solids. Due to its deteriorating condition, the sewer system also occasionally experiences problems with excessive inflow and infiltration and sanitary sewer overflows.

Pursuant to §393.320, RSMo, three appraisers were hired to prepare a joint appraisal. These appraisers hired an engineering firm, Flinn Engineering, to develop an asset inventory, estimate the assets' ages, assess the utilities' conditions, calculate their current replacement cost, and depreciate them based upon MAWC's approved depreciation schedule.<sup>2</sup> Despite never visiting the systems, Flinn Engineers produced two studies, the first is dated January 18, 2020, and the second is dated March 16, 2020. Accordingly, the appraisers produced two appraisals, the first is dated January 20, 2020, and the second is dated March 23, 2020.

The first engineering study, dated January 18, 2020, values the water system at approximately \$10.6 million and the sewer system at approximately \$5.5 million, for a total of approximately \$16.1 million.<sup>3</sup> The first appraisal, dated January 20, 2020,

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<sup>1</sup> Ex. 101, *Staff Recommendation*, P. 17, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).

<sup>2</sup> Tr. 203:11 – 204:1

<sup>3</sup> Ex. 103, *Jan 18, 2020 Flinn Engineering Report*, P. 6. The exact amounts are \$10,565,695 for the water system and \$5,521,205 for the sewer system, for a total of \$16,086,901.

appraises the water system at \$12.5 million and the sewer system at \$5.5 million, for a total of \$18 million.<sup>4</sup>

After the first engineering study and first appraisal were complete and submitted to MAWC, MAWC – the prospective purchaser – contacted Flinn Engineering about information which indicated an increased value.<sup>5</sup> Shortly thereafter, Flinn Engineering produced a second engineering report, dated March 16, 2020, valuing the water system at approximately \$18.2 million and the sewer system at approximately \$13.3 million, for a total of approximately \$31.5 million.<sup>6</sup> This is almost twice the original amount. In their second appraisal, the appraisers appraise the fair market value of the water system at \$18 million and the sewer system at \$10 million, for a total of \$28 million.<sup>7</sup> This is MAWC’s proposed purchase amount.

Staff filed its recommendation on October 1, 2021 recommending that the Commission reject MAWC’s application. Although Staff agrees that MAWC satisfies the first four Tartan factors, but not the fifth,<sup>8</sup> Staff wrote that using the appraised value of \$28 million as the basis for rate base is contrary to the public interest. Staff discussed that the Flinn Engineering reports, which the appraisers relied upon in preparing their appraisals, are deficient in that they do not acknowledge known deficiencies with the assets, blanketly stating that they are in “good” condition. Flinn Engineering’s review was inadequate, because it did not personally inspect the systems prior to producing its

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<sup>4</sup> Ex. 300, *Jan 20, 2020 Valuation Report*, P. 76.

<sup>5</sup> Tr. 214:1-11 and Ex. 107, *MAWC Response to DR 60 (emails between MAWC and Flinn Engineering)*, P. 17-24.

<sup>6</sup> Ex. 9, *Mar 16, 2020 Flinn Engineering Report*, P. 6, attached to *Direct Testimony of Kelly A. Simpson*. The exact amounts are \$18,155,170 for the water system and \$13,293,844 for the sewer system, for a total of \$31,449,014.

<sup>7</sup> Ex. 3, *Mar 23, 2020 Valuation Report*, P. 75, attached to *Direct Testimony of Joseph E. Batis*.

<sup>8</sup> *In re Tartan Energy Co.*, 3 Mo. P.S.C. 3d 173, 177 (Sept 16, 1994). The fifth Tartan factor is that the service must promote the public interest.

reports, and it did not even research publically-available open request DNR records. Additionally, Flinn Engineering fails to acknowledge that the wells and water treatment equipment will be functionally abandoned as part of the acquisition. And finally, the reports do not acknowledge that there are two versions of the report and neither report acknowledges the existence of the other.

To assist the Commission, Staff created an estimated net book value for the Eureka assets based upon the traditional method of calculating net book value for ratemaking purposes. Staff estimates a net book value for the water system of \$10,709,736 and \$7,096,878 for the sewer system, for a combined total of \$17,806,614.<sup>9</sup> This is approximately the same as the appraisers' first appraisal, but almost \$10 million less than the proposed purchase price.

On October 12, 2021, MAWC responded to Staff's report, arguing that the appraisal conforms to the requirements of §393.320, RSMo.<sup>10</sup> MAWC stressed that Eureka residents attended town hall meetings and voted to sell their systems to MAWC for \$28 million.<sup>11</sup> MAWC also asserted that the Commission has no role in determining whether the transaction is in the public interest, because MAWC decided to purchase the systems according to the appraisal statute, and that in the appraisal statute, the "General Assembly has already addressed the public interest."<sup>12</sup>

Thereafter, the Commission ordered a procedural schedule. MAWC submitted testimony that was entered into evidence from Jeffrey Kaiser, MAWC Vice President of

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<sup>9</sup> Ex. 102, *Rebuttal Testimony of Amanda C. McMellen*, 2:1-5 (Dec 3, 2021) and Ex. 101, *Staff Recommendation*, P. 21, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).

<sup>10</sup> MAWC's *Response to Staff Recommendation*, ¶¶15-16 (Oct 12, 2021).

<sup>11</sup> *Id.* at ¶¶ 2-3.

<sup>12</sup> *Id.* at ¶¶ 10-12.

Operations; Brian Eisenloeffel, MAWC Senior Director of Operations for the St. Louis region; Brian LaGrand, MAWC Director of Rates and Regulatory Support; Sean Flower, Eureka's mayor; Joseph Batis, one of the three appraisers; and Kelly Simpson, owner of Flinn Engineering. Staff submitted testimony that was entered into evidence from Curt Gateley, Manager of the Staff Water and Sewer Department, and Amanda McMellen, a Utility Regulatory Audit Supervisor. A hearing was held on January 20 and 21, 2022. Although the Office of Public Counsel (OPC) did not submit testimony, it participated in the hearing.

### **SECTION 393.320, RSMO**

Repeal by implication is disfavored.<sup>13</sup> If two statutes can be reconciled, both must be given effect.<sup>14</sup> Sections 393.320, RSMo and 393.170, RSMo can be reconciled, and both can be given effect. Section 393.320, RSMo establishes rate base, but it does nothing to affect the Commission's authority to determine whether issuing a CCN is necessary or convenient for the public service. Section 393.320, RSMo did not repeal the Commission's authority under §393.170, RSMo.

It is a basic rule of statutory interpretation that to the extent possible, statutes should be harmonized and not read to create conflict. The theory behind this is that a statute becomes a part of a unified whole and its parts are directed toward one coherent purpose. As a result, an interpretation that would cause one provision of a statute to clash with its counterparts is disfavored.<sup>15</sup> Here, the coherent purpose is to ensure that

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<sup>13</sup> *St. Charles County v. Director of Revenue*, 961 S.W.2d 44, 47 (Mo.banc 1998). See also, *State ex rel. Coffman v. Pub. Serv. Comm'n*, 154 S.W.3d 316, 328 (Mo.App.W.D. 2004).

<sup>14</sup> *Id.*

<sup>15</sup> *Hovis v. Daves*, 14 S.W.3d 593, 596 (Mo.banc 2000) and *State ex rel. Evans v. Brown Builders Elec. Co.*, 254 S.W.3d 31, 35 (Mo.banc 2008).

utilities provide safe and adequate service at charges set by the Commission that are just and reasonable. Without a Commission determination whether a transaction under the appraisal statute is necessary or convenient for the public service, utilities will have a blank check to increase their rate base via the appraisal statute without any inquiry into the public interest.

MAWC seeks to purchase the Eureka systems pursuant to the appraisal statute, §393.320, RSMo, which would establish rate base as the systems' appraised value, plus reasonable closing and transition costs,<sup>16</sup> and incorporate the Eureka systems into MAWC's existing service areas.<sup>17</sup> At the same time, §393.170(3), RSMo requires the Commission to find that granting MAWC a CCN for the area is "necessary or convenient for the public service."<sup>18</sup> Contrary to the clear instructions from Missouri Courts to read statutes in harmony, and avoid repeal by implication, MAWC claims that by enacting §393.320, RSMo the Legislature intended to abrogate the Commission's statutory duty to determine whether the transaction is in the public interest and that the Commission must accept MAWC's highest appraisal at face value.<sup>19</sup> However, for the reasons explained below, the Commission should find that there is no conflict between the appraisal statute and the Commission's statutory requirement to determine whether the transaction is necessary or convenient for the public service.

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<sup>16</sup> §393.320.5., RSMo.

<sup>17</sup> §393.320.6., RSMo.

<sup>18</sup> "The 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." *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo.E.D. 1980) (citing *State ex rel. City of St. Louis v. Public Service Commission of Missouri*, 73 S.W.2d 393, 400 (Mo.banc 1934)).

<sup>19</sup> *MAWC's Response to Staff Recommendation*, ¶10 (Oct 12, 2021). ("Through the enactment of §393.320, RSMo, the General Assembly has already addressed the public interest. The Staff should not be allowed to add its own layers of analysis on a statute that is clear in its intents and execution.")

Rather than read §393.320, RSMo and §393.170(3), RSMo together, MAWC's interpretation creates an impermissible conflict between §393.320, RSMo and §393.170(3), RSMo. The Commission cannot do both – it cannot on one hand, accept MAWC's appraisal without making a determination whether it is necessary or convenient for the public service (MAWC's interpretation) and on the other hand, make its required determination whether the transaction is necessary or convenient for the public service. In contrast, Staff's interpretation is that the transaction can be completed pursuant to the appraisal statute, but only if it is necessary or convenient for the public service. Staff's interpretation creates no conflict and therefore, the Commission should accept it. This is also the interpretation that advances the legislation's purpose of serving the public; the legislation's purpose is not to increase MAWC's portfolio. Otherwise, not only will the Commission be in dereliction of its duty to determine whether the transaction is necessary or convenient for the public service, its role will be reduced to being a rubber-stamper for the many applications utilities will likely file pursuant to the appraisal statute.

**1. This transaction is not necessary or convenient for the public service within the meaning of §393.170, RSMo, because MAWC seeks to purchase the Eureka systems at an inflated price and Eureka ratepayers have already paid for the systems.**

The transfer of the Eureka water and sewer systems to MAWC is not necessary or convenient for the public service, because MAWC seeks to purchase the Eureka systems at an inflated price. Moreover, as the Flinn Engineering report states, many of the assets have been fully depreciated,<sup>20</sup> indicating that the Eureka ratepayers have already paid for them. It would be inequitable for other MAWC ratepayers to pay for these systems again, and it would be a windfall for the City of Eureka to be paid twice for them.

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<sup>20</sup> Ex. 9, Mar 16, 2020 Flinn Engineering Report, P. 7, attached to Direct Testimony of Kelly A. Simpson.

Although MAWC carries the burden to prove that this proposed transaction is necessary or convenient for the public interest, Staff prepared its estimate of net book value to assist the Commission. Staff's report and resulting valuation is more thorough than Flinn Engineering's report, because Staff actually inspected the systems and obtained publically-available DNR records. Additionally, Staff reviewed records from MAWC and the City of Eureka, as well as MAWC's application, feasibility study, the Flinn Engineering studies, the second appraisal, and MAWC's responses to Staff data requests. Staff determined the net book value for the Eureka assets by studying documentation related to the cost of constructing plant, assigned depreciation rates for each Uniform System of Accounts (USOA) category of plant-in-service, and considered whether there was contributed plant.<sup>21</sup> Staff estimates a net book value for the water system of \$10,709,736 and \$7,096,878 for the sewer system, for a combined total of \$17,806,614.<sup>22</sup>

Staff's estimated net book value is approximately \$10.2 million less than MAWC's contracted purchasing price. If the Commission approves this transaction, MAWC will ask its other customers – in addition to its new Eureka customers – to pay for the systems' inflated rate base and proposed upgrades. While Eureka citizens voted to sell their water and sewer utilities and receive substantial payment for them, other MAWC ratepayers did not have this opportunity, but will be forced to pay for them at an inflated price. The appraisal statute's purpose is to encourage the purchase of small troubled systems by providing large companies with a financial incentive. However, the transaction must still

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<sup>21</sup> Ex. 102, *Rebuttal Testimony of Amanda C. McMellen*, 2:6-13, 4:1-8 (Dec 3, 2021) and Ex. 101, *Staff Recommendation*, P. 23-24, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).

<sup>22</sup> Ex. 102, *Rebuttal Testimony of Amanda C. McMellen*, 2:1-5 (Dec 3, 2021) and Ex. 101, *Staff Recommendation*, P. 21, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).



be necessary or convenient for the public service. MAWC's proposed transaction is not, because of the disparity (approximately \$10.2 million) between MAWC's appraisal and Staff's estimated net book value and because its appraisal is deficient. A difference of 45% between appraised value and net book value is beyond the financial incentive reasonably intended by the appraisal statute.

Additionally, according to the Flinn Engineering reports, the City of Eureka has already depreciated many of the utilities' components. In its summary, Flinn Engineers writes that "[a]lthough many of the assets are fully depreciated, they are still in operation and could continue to stay in operation well beyond the depreciation period."<sup>23</sup> In other words, Eureka ratepayers have paid for the systems through their water and sewer rates. While the systems may have an appraised fair market value, this is distinguishable from the fact that Eureka residents have already paid for the systems over the years through depreciation. It would be clearly inequitable for MAWC ratepayers to pay – at an inflated price – for systems that have already been paid for in order to increase MAWC's rate base.

It would also be inequitable for the City of Eureka to receive double recovery for the systems – once through its customers' rates and second from MAWC's purchase. Commission approval of this transaction will be an undeserved windfall for both MAWC and the City of Eureka. The sewer system has not been compliant with DNR regulations for at least five years. Planning on this sale, the City of Eureka deferred maintenance, at the risk of residents' health and safety. Moreover, Eureka residents do not like Eureka water for aesthetic reasons. The City of Eureka is motivated to sell, because it alleviates

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<sup>23</sup> Ex. 9, Mar 16, 2020 Flinn Engineering Report, P. 7, attached to *Direct Testimony of Kelly A. Simpson*.

it from financing investments to make the systems safe, bring them into DNR compliance, and produce palatable water. There is nothing wrong with being a motivated seller, but the City of Eureka should not be paid twice for the same utilities.

Public policy requires the Commission avert this potential inequity. Considering the entirety of the public interest, approving this transaction at a rate base significantly higher than its estimated net book value, combined with the fact that Eureka residents have already paid for the systems, this acquisition is not necessary or convenient for the public interest, and the Commission should not approve it.

**2. This transaction is not necessary or convenient for the public service within the meaning of §393.170, RSMo, because MAWC did not follow the process in §393.320, RSMo to produce a sufficient, neutral appraisal.**

Section 393.320, RSMo specifies a process that MAWC must follow in order to acquire a utility at its appraised value, which includes obtaining an appraisal. This transaction is not necessary or convenient for the public service, because the appraisers did not follow the process to produce a sufficient, neutral appraisal. The appraisers relied upon information in a flawed and incomplete engineering report, which glosses over deficiencies. MAWC's appraisal is for a functioning water system, not an obsolete backup system, and a sewer system requiring significant repairs is not indicative of a system in "good" condition. Also, the appraisal contains no explanation why the appraisers chose a per customer value for the Eureka water system higher than any of their comparables' per customer value. And finally, contact between MAWC and Flinn Engineering suggests that MAWC directed the final engineering report's content.

**a. The appraisal is insufficient, because it is based on a flawed and incomplete engineering report.**

The appraisal is insufficient, because it is based on a flawed and incomplete engineering report. The engineering report avoids discussion of known deficiencies and lacks an independent asset inventory and production of values. Further, the engineering report fails to acknowledge that the wells and treatment equipment will be functionally abandoned with a MAWC purchase.

DNR records for the Eureka systems are readily available through an open DNR resources request. Although Flinn Engineering is aware how to request DNR records regarding the systems, it did not.<sup>24</sup> In fact, it does not appear that anyone involved in this case, except Staff, requested and reviewed the Eureka systems' DNR records.

If Flinn Engineering had accessed DNR records, it would have had to discuss in its reports that the sewer system has mechanical failures, its collection system needs significant repairs, and portions of its infrastructure are past its useful life.<sup>25</sup> DNR reports show that the system has failed to meet permit effluent limitations for biochemical oxygen demand (BOD) and total suspended solids (TSS) going back to at least October 2016.<sup>26</sup> Contrary to MAWC witness Mr. Eisenloeffel's testimony,<sup>27</sup> removal efficiency is indeed an

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<sup>24</sup> Tr. 211:18-22, 212:10-13.

<sup>25</sup> Ex. 101, *Rebuttal Testimony of Curt B. Gateley*, 5:16-18 (Dec 3, 2021).

<sup>26</sup> Ex. 6, *Aug 20, 2019 Referral Notice of Violation*, P. 13, attached to *Surrebuttal Testimony of Brian Eisenloeffel*. "The facility has failed to satisfy the required percent BOD and percent TSS removal efficiencies of 85 several times during the October 2016 through May 2019 period evaluated. Further, the Permittee has consistently failed to meet the required BOD removal efficiencies since approximately June 2018. The City is showing commitment to continue its work efforts toward satisfactorily resolving this issue. However, non-compliance is still an ongoing and substantial concern that needs to be resolved in a timely manner." *Id.*

<sup>27</sup> Ex. 6, *Surrebuttal Testimony of Brian Eisenloeffel*, 4:11-16 (Dec 17, 2021).

effluent limit in accordance with 40 CFR 133.102(a)(3) and (b)(3),<sup>28</sup> and DNR has cited Eureka on multiple occasions for this.<sup>29</sup> Mr. Eisenloeffel states that “[t]he letters and inspection reports must be considered in full to provide context,”<sup>30</sup> and then cites an August 9, 2019 DNR document for the proposition that Eureka did not fail to meet effluent limitations.<sup>31</sup> However, on page 10 of this document, DNR cites Eureka’s removal efficiency effluent violations:

In accordance with Table A-1 of MSOP MO-0039659, the Eureka WWTF is required to meet BOD and TSS removal efficiencies of 85 percent or more as a monthly average. ... Attachment #5 shows that the facility has failed to satisfy the required 85 percent BOD and 85 percent TSs removal efficiencies several times during the October 2016 through May 2019 period evaluated. Further the Permittee has consistently failed to meet the required BOD removal efficiencies since approximately June 2018 (**Referral Notice of Violation #5.a**). The lowest reported percent removals were 65 percent for BOD in August of 2018 and 7.9 percent for TSS in January of 2019.<sup>32</sup>

It is clear that the system has been, and likely continues to be, in violation of the permit effluent limits.

Additionally, the sewer system’s deteriorating pipes create problems with excessive inflow and infiltration (I&I) and sanitary sewer overflows (SSOs). Excessive I&I from groundwater can overwhelm the collection system’s capacity and impair performance of the sewage treatment plant, creating health and environmental hazards. SSOs are discharges of untreated sewage from the collection system that back up into basements and out of manholes, endangering public health and the environment. SSOs

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<sup>28</sup> Ex. 6, *Aug 20, 2019 Referral Notice of Violation*, P. 13, attached to *Surrebuttal Testimony of Brian Eisenloeffel*.

<sup>29</sup> *Id.*

<sup>30</sup> Ex. 6, *Surrebuttal Testimony of Brian Eisenloeffel*, 3:20-21 (Dec 17, 2021).

<sup>31</sup> *Id.* at 4:11-16.

<sup>32</sup> Ex. 6, *Aug 20, 2019 Referral Notice of Violation*, P. 110, attached to *Surrebuttal Testimony of Brian Eisenloeffel*.

are most often created by damaged collection system components. Some of Eureka's SSO discharges were due to flooding, while others were due to excessive I&I overwhelming the collection system or failures of collection system components.<sup>33</sup> MAWC acknowledges these issues in its response to Staff DR No. 0033<sup>34</sup> to justify planned spending on the sewer system, but interestingly MAWC contradicts this position in testimony when attempting to justify the inflated proposed purchase price.<sup>35</sup>

Flinn Engineering paints a substantially rosier picture of the systems. Flinn Engineers summarizes, "Overall the water and wastewater systems appear to be in good condition and well-maintained."<sup>36</sup> When describing individual components' condition, a

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<sup>33</sup> Ex. 101, *Rebuttal Testimony of Curt B. Gateley*, 3:9-4:12 (Dec 3, 2021).

<sup>34</sup> MAWC stated in response to DR 0033 when asked about investments MAWC will need to make to bring the sewer system into compliance:

The City of Eureka is currently in enforcement for not meeting effluent limits (BOD and TSS removal efficiency). They also had several SSOs in 2019-2020. Both are violations of the Missouri Clean Water law.

To address on-going non-compliance with the system's Missouri State Operating Permit Final Effluent Limitations (MSOP FEL), specifically exceeding the BOD and TSS removal efficiencies, the Eureka wastewater treatment facility (WWTF) needs to have the following issues addressed, including, but not limited to: fixing the aeration system, addressing issues with influent screening, replacing/maintaining the Aquamat system, addressing sludge build-up in lagoon, and fixing/replacing recirculation pumps. Most of these items are routine in nature and can be quickly fixed by MAWC.

The current Schedule of Compliance in the WWTF's MSOP indicates the WWTF will be subject to new ammonia limits in October of 2022. While this is not an immediate need, having that awareness is an important part of prioritizing any investment. It also puts greater importance of making repairs timely to see what the facility is capable of achieving in terms of treatment.

The collection system experienced several Sanitary Sewer Overflows (SSOs) in 2019-2020, a violation of Missouri Clean Water law (discharging pollutants to the environment without a permit). To prevent future SSOs, several of the system's lift stations need to be upgraded / repaired and significant I&I issues addressed. Missouri American Water projects spending \$2.65M to address these issues over the next 8 years. Additional field inspections, smoke testing, I&I studies, and camera work is needed to prioritize this work. This type of in-depth investigative work is routinely performed as part of operating a wastewater collection system, but has not been done by the city in some time.

<sup>35</sup> Ex. 6, *Surrebuttal Testimony of Brian Eisenloeffel*, 3:9-8:7 (Dec 17, 2021).

<sup>36</sup> Ex. 9, *Mar 16, 2020 Flinn Engineering Report*, P. 7, attached to *Direct Testimony of Kelly A. Simpson*.

common litany is that it is “fully depreciated, but is still in operation and could continue to stay in operation well beyond the depreciation period.”<sup>37</sup> The most critical thing that Flinn Engineering writes about the Eureka systems is that the water storage tanks have “some mildew.”<sup>38</sup> The engineering report is silent concerning DNR violations, because Flinn Engineering did not research DNR reports and MAWC did not provide the information.<sup>39</sup> Flinn Engineering does not acknowledge that if MAWC purchases the systems, the water system will be largely redundant, because its wells and water treatment equipment will be relegated to mere “back-up” status. In fact, part of Eureka’s motivation to sell its water system is to obtain a different source of water.<sup>40</sup> The fact that the water system produces water that people do not want to drink effects the system’s value. Additionally, future use is relevant and should have been considered because the appraisal statute is prospective in scope, establishing the amount ratepayers will pay in the future for the systems.

Compounding Flinn Engineering’s failure to access DNR reports is that Flinn Engineering did not personally inspect the systems before writing their reports and for this reason, made assumptions about conditions and functionality.<sup>41</sup> In lieu of personally visiting the site, Flinn Engineering relied upon photos taken by non-engineers during a site visit.<sup>42</sup> In lieu of independently producing values, Flinn Engineering relied

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<sup>37</sup> *Id.* at 2, 3, 4, 7.

<sup>38</sup> *Id.* at 2.

<sup>39</sup> Tr. 211:14-22. Kelly Simpson of Flinn Engineering testified that DNR issues do not reflect condition, but would not explain why that is. Tr. 211:23-212:9.

<sup>40</sup> Ex. 7, *Direct Testimony of Jeffery T. Kaiser*, 5:6-18 (Nov 5, 2021) and Ex. 101, *Staff Recommendation*, P. 21-22, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).

<sup>41</sup> Tr. 207:22-208:2, Tr. 210:17-23, and Ex. 9, *Mar 16, 2020 Flinn Engineering Report*, P. 1, attached to *Direct Testimony of Kelly A. Simpson*.

<sup>42</sup> Ex. 301, *Undated photographs Flinn Engineering reviewed to prepare its reports*.

upon insurance values for the above ground assets and on information from the City of Eureka, vendors, and contractors for the below ground assets.<sup>43</sup> This methodology of preparing reports runs counter to Staff's experience. Staff's experience is that in preparing its reports and valuations, consulting engineers review a system's physical condition and compliance history, because whether a system mechanically functions as it should is a crucial part of an engineer's determination. By not making a visual inspection, Flinn Engineering overlooked issues that should have been apparent to an engineer.

MAWC is aware that the sewer system requires substantial investment.<sup>44</sup> Eureka has been working with DNR to meet new ammonia limits, and its compliance deadline is October 1, 2022. In 2018 the City of Eureka notified DNR that it planned to construct a new treatment plant to meet ammonia limits.<sup>45</sup> MAWC stated that if it acquires the Eureka sewer system, it may invest \$18 million in upgrades to meet these new DNR ammonia limits, but before doing this it will first operate the existing treatment system to determine if it is capable of meeting the effluent limits. Other improvements MAWC would make include \$2.65 million for lift station replacement, upgrades, and repairs.<sup>46</sup>

In sum, Flinn Engineering's reports lacks meaningful consideration of the utilities' true condition. Whether a utility provides safe and adequate service and meets DNR standards is a critical part of an engineer's determination.<sup>47</sup> By not reviewing

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<sup>43</sup> Ex. 9, *Mar 16, 2020 Flinn Engineering Report*, P. 1, attached to *Direct Testimony of Kelly A. Simpson*.

<sup>44</sup> See Footnote 35.

<sup>45</sup> Ex. 101, *Staff Recommendation*, P. 18-19, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).

<sup>46</sup> *Id.* at P. 20.

<sup>47</sup> Ex. 101, *Rebuttal Testimony of Curt B. Gateley*, 5:21-6:2 (Dec 3, 2021).

publically-available DNR compliance history and not physically inspecting the systems to verify their condition, Flinn Engineering did not consider information that influences the appraised value. The Commission can reject MAWC's application, because the engineering reports that the appraisers relied upon are flawed.

**b. The appraisal is insufficient, because it lacks an explanation why the appraisers chose a per customer value for the Eureka water system higher than any of their comparables' per customer value.**

There are different methods of appraising and determining fair market value. An appraiser using the sales comparison approach compares the subject property to recently sold properties with similar characteristics. Another is the cost method. An appraiser using the cost method estimates the new cost of constructing the improvements, subtracts depreciation, and then adds the value of the underlying land. Flinn Engineering's valuations are based upon the new cost of constructing the improvements, less depreciation.

The appraisers created a fair market value for the Eureka assets using the sales comparison approach. To do this, they gathered information about recent sales of other small water and sewer utilities and determined each's value on a per customer basis. These values ranged from \$2,700 to \$4,157, with a median value of \$3,528 and mean of \$3,416. They assigned a per customer value of \$4,500 to the Eureka systems – which is higher than any of their comparables. The appraisers multiplied their \$4,500 per customer value by 4,009 reported Eureka customers to reach a value of \$18,040,000 (adjusted to \$18 million) for the Eureka water system.<sup>48</sup>

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<sup>48</sup> Ex. 3, Mar 23, 2020 Valuation Report, P. 70, 75, attached to Direct Testimony of Joseph E. Batis.



The appraisers offer no explanation why they believe the Eureka water system is worth 8.25% more than their next most expensive comparable. Without this explanation, the Commission cannot determine whether an adequate basis exists for appraising the Eureka water system at \$4,500 per customer, and the Commission may reject MAWC's application because its appraisal is insufficient.

**c. The appraisal is insufficient, because contact between MAWC and the Flinn Engineering suggests that MAWC directed the engineering report's content.**

The three appraisers hired Flinn Engineering to assess the utilities' condition, calculate their 2019 estimated cost, and depreciate them based on MAWC's approved depreciation schedule. The emails between Flinn Engineering and MAWC, as well as the timing of the second report, causes Staff to question whether the appraisers were free from influence. Flinn Engineering's first report, dated January 18, 2020, estimates the total value of the Eureka assets at approximately \$16.1 million. The first appraisal, dated January 20, 2020, appraises the water system at \$12.5 million and the sewer system at \$5.5 million, for a total of \$18 million.<sup>49</sup>

Despite the fact that Flinn Engineering was the appraisers' client – not MAWC's – Derek Linam, MAWC Engineering Manager, telephoned Kelly Simpson of Flinn Engineering after the date of the first engineering report.<sup>50</sup> He emailed her on February 6, 2020, requesting a meeting.<sup>51</sup> The next day, Mr. Linam emailed Ms. Simpson:

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<sup>49</sup> Ex. 300, *Jan 20, 2020 Valuation Report*, P. 76.

<sup>50</sup> Tr. 214:1-11.

<sup>51</sup> Ex. 107, *MAWC Response to DR 60 (emails between MAWC and Flinn Engineering)*, P. 24.

Kelly,

We can probably discuss on the phone. I wanted to review the assumption that the system was 70% built by the 1950's. I pulled some statistics from parcels out of GIS and wondered how it might change the depreciated value if we use some different assumptions. I'm available at 1:30 p.m. if that works for you and we can chat via phone or if you'd like to meet in person we can do that too.

Derek<sup>52</sup>

Mr. Linam and Ms. Simpson exchanged several emails about discussing "various assumptions" and planned to meet. In advance of meeting, Mr. Linam supplied Ms. Simpson with his spreadsheet of parcel data, and writes, "Again, just wondering how a 'newer' system assumption will impact depreciated value for the water and waste water distribution and collection systems."<sup>53</sup> Ms. Simpson also sent Mr. Linam her spreadsheet so he can "try some different percentages."<sup>54</sup> This exchange suggests that the parties planned to experiment with values to obtain a different outcome.

Shortly thereafter, on March 16, 2020, Flinn Engineering produced its second report, valuing the water system at approximately \$18.2 million and the sewer system at approximately \$13.3 million, for a total of approximately \$31.5 million.<sup>55</sup> This is almost twice the original amount. In their second appraisal, the appraisers' fair market value of the water system is \$18 million and the sewer system is \$10 million, for a total of \$28 million. This is MAWC's proposed purchase amount.

These emails suggest that MAWC was involved in directing the process for producing the engineering report and was in control of its content. It runs counter to

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<sup>52</sup> *Id.* at P. 23

<sup>53</sup> *Id.* at 17.

<sup>54</sup> *Id.*

<sup>55</sup> Ex. 9, Mar 16, 2020 Flinn Engineering Report, P. 6, attached to *Direct Testimony of Kelly A. Simpson.*

common experience that a prospective purchaser would seek to increase the purchase price. Flinn Engineering's explanation for the different reports is that MAWC wanted the engineers to have "the most accurate information."<sup>56</sup> But if MAWC wanted the engineering report to contain the most accurate information, why did it not inform Flinn Engineering about known problems with the systems and DNR issues? What the emails between MAWC and Flinn Engineering,<sup>57</sup> and also the emails between Flinn Engineering and the appraisers,<sup>58</sup> do not show is consideration of the utilities' condition. There is no substantive discussion of the utilities' condition, required repairs and maintenance, status of DNR enforcement action, or whether the systems are meeting DNR standards.

Furthermore, neither the second engineering report nor the second appraisal refer to the first ones. The first reports are clearly not drafts; they were meant as final reports. A subsequent report will usually refer to an earlier report to make the reader aware that there is an earlier version. This lack of reference also causes Staff to question the openness and neutrality of this process. But for MAWC contacting Flinn Engineering, MAWC's purchase price would be \$18 million, which is close to Staff's estimated net book value of \$17,806,614.

## **SUMMARY**

Section 393.320, RSMo gives the Commission little discretion in establishing the appropriate rate base for a small system when it is purchased by a large water public utility. However, the Commission still must determine if the issuance of a CCN, regardless

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<sup>56</sup> Tr. 219:25-220:3.

<sup>57</sup> Ex. 107, MAWC Response to DR 60 (emails between MAWC and Flinn Engineering).

<sup>58</sup> Ex. 108, MAWC Response to DR 61 (emails between MAWC and the appraisers).

of what special ratemaking treatment may be attached to it, is in the public interest. In this situation, MAWC requests Commission approval of a transaction with sales prices substantially above the time-tested regulatory valuation of those systems. MAWC is not asking to have its shareholders pay the \$10,193,386 difference between the appraised value of the systems and Staff's calculation of their net book value, it is asking all other customers in St. Louis County to pay this additional amount in order to add these systems to its portfolio. Further, MAWC will ask the rest of its customers in St. Louis County to help pay for the upgrades to Eureka's systems.

When the entirety of the public interest is viewed from this perspective, combined with consideration of the uncertainty surrounding the Flinn Engineering reports, and potential insufficiency of the appraisals, Staff's position is that setting rate base for these systems based upon an appraisal that relied, at least partly, upon the Flinn Engineering reports is not in the public interest. While Eureka's drinking water may not have the best flavor, it currently meets DNR requirements and is drinkable. While improvements to Eureka's water and sewer utilities may be desirable or necessary, the City of Eureka can accomplish them by taking advantage of public funding sources available to municipalities. Eureka's water and sewer systems are not troubled utilities, and no emergency would be solved simply by MAWC's acquisition of these systems. Eureka residents have alternatives, if the sale to MAWC does not occur.

The Commission should not approve MAWC's application, because overall, it is not necessary or convenient for the public service.

**3. If the Commission grants MAWC's application for the CCNs:**

**a. What conditions, if any, should the Commission impose?**

The Commission should approve all conditions listed in Staff's recommendation.<sup>59</sup>

**b. Of which existing service areas should the Eureka water and wastewater systems become a part?**

If the Commission approves MAWC's application, Staff is not opposed to the Eureka water system becoming a part of the St. Louis County customer base and the sewer system becoming a part of the MAWC's "Other Missouri" customer base.

**4. Does §393.320, RSMo, require the Commission to establish the ratemaking rate base in this case for the Eureka water and wastewater systems? If so, what is the ratemaking rate base that should be established?**

The appraisal performed for the Eureka water and wastewater systems is deficient and should not trigger the requirements of §393.320, RSMo. In addition, §393.320, RSMo, does not override the Commission's independent decision whether to approve a CCN under §393.170, RSMo, and for the reasons explained above, approving the transaction at MAWC's appraised value is not necessary or convenient for the public service. Staff recommends that the Commission reject MAWC's application. If the Commission denies the acquisitions, there is no need to establish a rate base.

If the Commission finds that MAWC's appraisal meets the requirements of §393.320, RSMo, and if the Commission approves MAWC's application according to the process described in §393.320, RSMo, the Commission must establish rate base at the systems' appraised value of \$28,000,000, plus reasonable closing and transition costs.<sup>60</sup>

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<sup>59</sup> Ex. 101, *Staff Recommendation*, P. 21-23, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).

<sup>60</sup> §393.320.5., RSMo.

Respectfully submitted,

**/s/ Karen E. Bretz**

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**CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been electronically mailed to all parties and/or counsel of record on this 18th day of February, 2022.

**/s/ Karen E. Bretz**