

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

In the Matter of the Application of Confluence Rivers)
Utility Operating Company, Inc., for Authority to) **File No. WA-2019-0299**
Acquire Certain Water and Sewer Assets and for a)
Certificate of Convenience and Necessity)

STAFF’S REPLY POST HEARING BRIEF

COMES NOW Staff of the Missouri Public Service Commission, through counsel, and files its reply post hearing brief.

As they did at the hearing, the Lake Perry Lot Owners Association (“Association”) and the Office of Public Counsel (“OPC”) argue in their initial briefs that the purchase price of the water and wastewater assets of the Port Perry Service Company, LLC (“Port Perry”) will be detrimental to the public interest, ignoring the fact that rates will be based upon net book value. All parties agreed on the systems’ net book value. The Association’s and OPC’s arguments are so disassociated from net book value that they fail to discuss how net book valuation of Port Perry’s assets for ratemaking purposes will be detrimental to the public interest. Confluence Rivers Utility Operating Company, Inc. (“Confluence”) is not requesting recovery of any acquisition premium, therefore the Commission will not consider the systems’ purchase price for ratemaking purposes. Further, Staff determined that Confluence has the financial capacity to buy and operate these systems. For these reasons, the Commission should discount the Association’s and OPC’s arguments as irrelevant.

ARGUMENT

1. **Applying Supreme Court precedent to this case, there is no detriment to the public and the Commission must approve the acquisition.**

In the *Freight Transport* cases, the Commission denied a common carrier's application to expand its CCN, finding that existing common carriers provided adequate service and an additional carrier would adversely affect them.¹ The Supreme Court affirmed the decision, stating:

The Commission has the responsibility of determining's the public's need for common-carrier service sought and of considering a new, enlarged, extended or additional, and duplication of service would adversely affect presently authorized carrier service with resultant deterioration of efficiency in adequately supplying the transportation needs of the public. In the determination of these matters, the right of an applicant, with respect to the issuance of a certificate of convenience and necessity, are considered subservient to the public interest and convenience.²

The Missouri Supreme Court emphasizes the strength of utility owners' rights, stating that "property owners should be allowed to sell [their] property *unless it would be detrimental to the public.*"³ The Commission does not take on the role of auctioneer or involve itself in parties' arms-length transactions:

To prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be benefited, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public detriment. 'In the public interest,' in such cases, can reasonably mean no more than 'not detrimental to the public.'⁴

¹ *Missouri Pac. Freight Transport Co. v Public Service Commission*, 295 S.W.2d 128, 131 (Mo. 1956).

² *Id.* at 132.

³ *State ex rel. City of St. Louis v. Public Serv. Com'n.*, 73 S.W.2d 393, 399 (Mo. banc 1934) (emphasis added).

⁴ *Id.* at 400 (internal citations omitted).

There is no indication that the Port Perry / Confluence transaction is anything other than an arms-length transaction. Port Perry has not proposed selling its assets to the Association, and the Commission cannot force it to.⁵ A property owner has the right to sell its property for the highest value it can. In the context of regulated utility property, the Commission's place is to determine whether there is detriment to the public stemming from the assets' sale at the agreed upon price. The parties agree on the Port Perry assets' net book value and that rates will be based on that net book value. This, combined with the fact that Confluence has the financial ability to purchase the assets, removes potential detriment based on the purchase price. The Association's sour grapes are not a detriment to the public.

The Association cites a Commissioner statement made during the February 13, 2020 Agenda Meeting in different cases for the proposition that the Commission wrongly interprets Missouri Supreme Court precedent. During case discussion for the application of Osage Utility Operating Company, Inc. ("Osage Utility") to acquire water and sewer systems and accompanying certificates of convenience and necessity ("CCNs"), Commissioner Rupp said,

I don't want to be sending a message to other companies that are looking at distressed systems, saying, "Hey, come on out here and bid and if we don't like you and we can find a public entity then we are just going to hand it to them." I don't think it is detrimental to the public interest.⁶

The public entity Commissioner Rupp referred to was a group consisting of a public water supply district and two other nonprofit organizations ("Joint Bidders"), which were

⁵ *City of O'Fallon v. Union Elec. Co.*, 462 S.W.3d 438, 444 (Mo. App. E.D. 2015).

⁶ *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 and SA-2019-0186, Agenda case discussion at approximately 33:00 (Feb 13, 2020).

the second highest bidders in the bankruptcy sale of the utility assets.⁷ Osage Utility, a sister company of Confluence, was the highest bidder. Similar to the Association and OPC in this case, the Joint Bidders claimed it would be detrimental to the public interest for Osage Utility to acquire the systems because the Joint Bidders could deliver better service under customer governance and rates would rise under Osage Utility ownership. The Commission found Osage Utility possesses the technical, managerial and financial capabilities to provide safe and adequate service. It noted Osage Utility’s “proven track record of bringing distressed systems into compliance and operating them in a safe and adequate manner.”⁸ The Commission discussed the fact that rates would increase regardless of ownership and that under Osage Utility ownership, a rate increase would not occur until after a future rate case, while the Joint Bidders could raise rates immediately without Commission oversight. In summary, the Commission found that transfer of the assets to Osage Water would not be detrimental to the public interest and approved the transaction.⁹

From the onset, the Commission may disregard the Association’s argument, because it cites to information outside the record of this case. However, Staff will state that in context, Commissioner Rupp made the above statement while describing how Osage Utility has a good history of rehabilitating distressed systems and provides quality service. Staff interprets Commissioner Rupp’s comments to mean that the Commission should apply the “not detrimental to the public interest” standard to the application actually before it, as opposed to choosing between competing entities. This is not related to an

⁷ *Motion to Intervene*, WA-2019-0185 and SA-2019-0186, ¶¶ 1-3, 15 (Jan 18, 2019).

⁸ *Report and Order*, WA-2019-0185 and SA-2019-0186, P. 35 (Apr 8, 2020).

⁹ *Id.* at 31 – 36.

applicants' rights versus the rights of the public. Nevertheless, the Association claims that the Commission wrongly interprets the *Freight Transport* cases¹⁰ by placing the rights of the regulated entity above those of the public.¹¹

The Association is putting words into Commissioner Rupp's mouth. Commissioner Rupp never suggested that the Commission elevates the applicant's rights above the public interest. Presumably, the Association believes that in this matter the public interest necessitates a finding that the Association would be the best owners of the Port Perry systems. However, as Commissioner Rupp implied – and Missouri Courts have clearly stated – the Commission has no authority to order a utility to sell its property.¹² The Commission is charged only with considering whether the application before it is detrimental to the public interest.¹³

2. The transaction's purchase price does not create a detriment to the public interest because Confluence will not recover the acquisition premium in rates.

In their briefs, the Association and OPC confuse purchase price and net book value to suit their needs. For example, the Association argues that Confluence is overpaying for the systems and its "extravagant investment history" creates detriment.¹⁴ OPC argues similarly.¹⁵ They assume that Confluence is overpaying for the systems due to the difference in the purchase price and net book value (This is the acquisition premium.). But as Staff explains throughout its initial brief, the purchase price will not create a

¹⁰ *State ex rel. Mo. Pac. Freight Transport Co. v. Public Service Commission*, 288 S.W.2d 679 (Mo. App. 1956) and *Missouri Pac. Freight Transport Co. v. Public Service Commission*, 295 S.W.2d 128 (Mo. 1956).

¹¹ *Lake Perry Lot Owners Association Initial Brief*, P. 4 (Jun 2, 2020).

¹² *City of O'Fallon v. Union Elec. Co.* 462 S.W.3d 438, 444 (Mo. App. W.D. 2015) (citing § 393.190, RSMo (Supp. 2013)).

¹³ *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo. App. 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)).

¹⁴ *Lake Perry Lot Owners Association Initial Brief*, P. 8 (Jun 2, 2020).

¹⁵ *Second Brief of the Missouri Office of the Public Counsel*, P. 6 (Jun 2, 2020).

detriment to the public, because Confluence will not recover any of the acquisition premium in rates. Further, Exhibit 601C illustrates that Port Perry's purchase price is reasonable as related to purchase prices of comparable systems. The Association encourages the Commission to discount the information in Exhibit 601C for reasons unrelated to the purchase prices, which it does not argue are incorrect.¹⁶

Additionally, the Association attempts to distort Mr. Cox' testimony regarding the relation of the acquisition premium to Confluence's total investment.¹⁷ To show that Confluence can absorb the acquisition premium, Mr. Cox accurately testified twice at the hearing that the acquisition premium is between three and four percent of Confluence's total investment of property, plant, and equipment.¹⁸ The Association characterizes this as "deceptive if not completely wrong," because Mr. Cox did not compare the acquisition incentive to Confluence's current net book value.¹⁹ As the Association writes, it is true that Confluence will not earn a return on its total investment of property, plant, and equipment.²⁰ However, the Association ignores Confluence's nearly \$3.4 million of construction work in progress,²¹ which will be added to rate base once it is put into service.

The Association and OPC accuse Confluence of mismanagement that will cause it to become overleveraged, jeopardize service, self-deal, gold-plate projects, and/or

¹⁶ *Lake Perry Lot Owners Association Initial Brief*, P. 8 – 9 (Jun 2, 2020). No party objected to the information in Exhibit 601C. *Status Report and Motion for Late-Filed Exhibit*, ¶ 10 (May 26, 2020).

¹⁷ *Lake Perry Lot Owners Association Initial Brief*, P. 8 (Jun 2, 2020).

¹⁸ Tr. 380:8 – 9 and Tr. 384:19. Confluence reported \$4,318,872 in assets on page four of its 2019 report. The acquisition premium is \$152,064. $4,318,872 / 152,064 = .0352$

¹⁹ *Lake Perry Lot Owners Association Initial Brief*, P. 8 (Jun 2, 2020).

²⁰ *Id.*

²¹ *Confluence Rivers Utility Operating Company, Inc. Water and/or Sewer Annual Report*, P. 4 (Jun 2, 2020).

spread the acquisition premium among all Confluence customers.²² The Association cites Confluence's 2019 operating losses as evidence of mismanagement.²³ But again, the Association ignores nearly \$3.4 million of construction work in progress, which Confluence should be able to earn a return upon once it is placed in service and new rates are established.²⁴ It also disregards Confluence's mission, which includes rehabilitating distressed small water and sewer systems, which is consistent with the large plant expenses Confluence reported in its 2019 Annual Report.²⁵

Regarding Confluence's mission, the Association and OPC question the sincerity of Mr. Cox' testimony that Confluence's purpose is to buy distressed systems in order to provide safe and adequate water and sewer service to small communities. The Association brusquely calls Mr. Cox' testimony "a rather overblown marketing declaration,"²⁶ and OPC labels it "obvious nonsense" and "irrational."²⁷ Both parties overlook the fact that the Commission has approvingly cited the mission of Mr. Cox' companies,²⁸ as has OPC's own witness, Keri Roth.²⁹ Confluence's mission is not

²² *Lake Perry Lot Owners Association Initial Brief*, P. 9 – 10 (Jun 2, 2020) and *Second Brief of the Missouri Office of the Public Counsel*, P. 7 (Jun 2, 2020).

²³ *Lake Perry Lot Owners Association Initial Brief*, P. 9, 11 (Jun 2, 2020).

²⁴ *Confluence Rivers Utility Operating Company, Inc. Water and/or Sewer Annual Report*, P. 4 (Jun 2, 2020). Also, since this Annual Report Confluence completed a rate case which should create revenues that will offset operating expenses.

²⁵ *Id.* at W-1, S-1 (Jun 2, 2020). For 2019, Confluence reported \$292,399 in water plant expenses and \$368,670 in sewer plant expenses. Placing this in perspective, the Association's consulting engineer testified that the Port Perry systems require \$580,000 in repairs and the sewer system requires \$90,000 in repairs. Ex. 308, *Rebuttal Testimony of Chad Sayre*, "Preliminary Engineering Report Summary, Lake Perry Lot Owners' Association" § 4.0 (Aug 23, 2019).

²⁶ *Lake Perry Lot Owners Association Initial Brief*, P. 7 (Jun 2, 2020).

²⁷ *Second Brief of the Missouri Office of the Public Counsel*, P. 6 (Jun 2, 2020).

²⁸ *Report and Order*, WA-2019-0185 and SA-2019-0186, ¶ 38 (Apr 8, 2020). ("Purchasing distressed systems to rehabilitate and operate them as a viable entity is the basic business plan of Central States.")

²⁹ Ex. 202, *Rebuttal Testimony of Keri Roth*, WA-2019-0185 and SA-2019-0186, P. 8 (Aug 13, 2019):

Q. Does [Osage Utility's] parent company [Central States Water Resources] ... have a history of acquiring failing or troubled systems?

undercut by seeking acquisition premiums in the Osage Utility cases, as OPC claims.³⁰ There is no contradiction between requesting an acquisition premium and servicing small communities.

CONCLUSION

The Association asserts that Commission authority for this transaction “will foreclose more reasonable transactions.”³¹ OPC vaguely warns that “Confluence’s willingness to significantly overpay for this system has already had a major effect on this case and will likely continue to have an effect moving forward.” OPC quotes Mr. DeWilde’s testimony for the proposition that Confluence’s bid for the systems created “a clear economic hurdle that prevented any other buyer from getting Port Perry’s ear.”³²

Confluence “got Port Perry’s ear” simply because it made the highest bid and has the present ability to purchase the systems. Last fall the Association had no cash, no income, and no financing. The Association’s bid was conditioned upon the Association receiving \$300,000 in cash from lot owners in order to purchase a certificate of deposit to use as leverage for a bank loan.³³ Although it had sufficient opportunity to do so, the Association failed to produce updated information about its financial position, and its financial state is likely weakened by fiscal obligations associated with this litigation. The

A. Yes. [Osage Utility’s] response to OPC data request 1108 ... explains that to date, [Central States Water Resources] affiliated companies have acquired several failing or troubled systems in Missouri and Arkansas.

³⁰ *Second Brief of the Missouri Office of the Public Counsel*, P. 5 (Jun 2, 2020).

³¹ *Lake Perry Lot Owners Association Initial Brief*, P. 10 (Jun 2, 2020).

³² *Second Brief of the Missouri Office of the Public Counsel*, P. 4 (Jun 2, 2020).

³³ Ex. 309, *Rebuttal Testimony of Richard DeWilde*, P. 7:3 – 12 (Aug 23, 2019). Mr. DeWilde testified last fall that the Association has ** _____ ** in pledges toward its goal, with an anticipated additional pledge that would cause it to meet the goal. However, Mr. DeWilde also stated that the pledges are only promises and there are no sanctions or enforcement if a lot owner decides not to follow through with his/her pledge. Tr. 302:11 – 306:3.

Association's rationalization of its inability to competitively bid for the Port Perry assets can be fairly attributed to resentment, not detriment.

The Commission should certainly consider the Association's desire to purchase the systems, its claims that it would be the better operator, and the assertions that Lake Perry customers "do[] not want Confluence Rivers' service."³⁴ However, the Commission must also weigh that information in context of the Commission's authority in this case, which is to review the proposed sale to Confluence. The proposed sale is not detrimental to the public because Confluence has the technical, managerial, and financial ("TMF") capacities to operate the system, and Confluence will not seek to recover any acquisition premium. The Commission has no authority to order Port Perry to sell its assets to the Association, the Association has no agreement with Port Perry to purchase its assets, and Port Perry has shown no willingness to contract with the Association. The Commission is tasked with analyzing the Confluence application before it, and it must approve this application if it is not detrimental to the public interest.³⁵ Staff's analysis of Confluence's TMF capacities and the Tartan Factors, combined with Confluence not recovering the acquisition premium in rates, demonstrates that the transaction does not create a detriment to the public interest – in fact, it is beneficial to the public interest – such that the Commission must approve it.

³⁴ *Lake Perry Lot Owners Association Initial Brief*, P. 11 (Jun 2, 2020).

³⁵ *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo. App. 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)).

Respectfully submitted,

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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 9th day of June, 2020.

/s/ Karen E. Bretz