

**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, ) **Case No. WA-2021-0376**  
Construct, Operate, Control, Manage and Maintain a )  
Water System and Sewer System in and Around the )  
City of Eureka, Missouri )

**MISSOURI-AMERICAN’S INITIAL BRIEF**

**COMES NOW** Missouri-American Water Company (“MAWC,” “Missouri-American” or “Company”), by and through the undersigned counsel, and states the following to the Missouri Public Service Commission (“Commission”) as its *Initial Brief*. This *Initial Brief* will address the issues described in the *Joint List of Issues, Order of Openings, Order of Witnesses, and Cross-Examination, and Order of Openings*, filed on January 5, 2022:

**Table of Contents**

INTRODUCTION .....	2
ISSUE 1 – Necessary or Convenient .....	3
Background .....	3
<i>Eureka</i> .....	3
<i>Appraisal</i> .....	5
<i>Election</i> .....	5
Standard .....	7
Assessment of Tartan Factors .....	7
Public Interest .....	9
ISSUE 2 - Conditions .....	12
Staff Conditions .....	12
Service Areas .....	12
ISSUE 3 – Section 393.320, RSMo .....	12
Section 393.320 .....	12
Commission Actions .....	13
Appraiser Qualifications and the Appraisal .....	13
Net Book Value .....	18
Ratemaking Rate Base .....	21
CONCLUSION .....	22

## INTRODUCTION

MAWC requests in this case certificates of convenience and necessity (CCN) to provide water and sewer service within the identified service area in and around the City of Eureka utilizing the Eureka systems.

The Commission may grant a “water corporation” and a “sewer corporation” a CCN to operate after determining that the construction and/or operation are either "necessary or convenient for the public service."<sup>1</sup> The Commission uses certain criteria, sometimes called the "*Tartan Factors*," evaluating applications for utility certificates of convenience and necessity.<sup>2</sup> MAWC explains herein that it satisfies those criteria.

This case primarily concerns the application of Section 393.320, RSMo, the “appraisal statute,” to a transaction between the City of Eureka and MAWC that had its origin in 2019. Eureka and MAWC have relied specifically on this statute – which is designed to encourage consolidation of small water and sewer systems into larger systems having greater economies of scale and resources.

Section 393.320 applies where the buyer (MAWC) is a “Large Water Public Utility,” that provides safe and adequate service, and the seller (Eureka) is a “Small Water Utility.” There is no dispute in this case that MAWC’s and Eureka’s water and sewer systems separately qualify. MAWC and Eureka have further complied with the statute’s direction regarding the process of obtaining an appraisal. Once Section 393.320 provisions have been chosen, the statute then requires that these procedures “shall be used” by the Commission.

Staff’s fundamental objection is that the fair market value, as determined by the certified appraisers, is different than the “net book value” estimated by the Staff. MAWC explains herein

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<sup>1</sup> Section 393.170.3, RSMo.

<sup>2</sup> *In Re Intercon Gas, Inc.*, 30 Mo P.S.C. (N.S.) 554, 561 (1991).

that a “net book value” is something completely different from a “fair market value” (“fair market value” being what is called for by Section 393.320) and, even if it were related, that the nature of a municipality and its accounting practices makes any attempt to estimate a net book value doomed from the start.

More importantly, the public interest has been expressed through statute – that being Section 393.320, the appraisal statute. Utilizing Section 393.320, regardless of Staff’s estimated net book value, cannot be contrary to the public interest.

The Commission should grant MAWC CCNs to provide water and sewer service within the proposed service area, subject to the conditions described by the Staff of the Commission and establish the ratemaking rate base for the Eureka water system and sewer system at the amounts identified in the Valuation Report, based on the facts and for the reasons specifically discussed in the following pages.

## **ISSUE 1 – Necessary or Convenient**

*Is MAWC’s provision of water and wastewater service associated with its proposed purchase of the City of Eureka water and wastewater systems “necessary or convenient for the public service” within the meaning of the phrase in Section 393.170, RSMo?*

### **Background**

#### ***Eureka***

The City of Eureka (“Eureka”) is a city of the Fourth Class located in St. Louis County, with a 2020 Census population of 11,646. (Exh. 1, Flower Dir., p. 3). Eureka owns and operates water and wastewater systems that serve approximately 4,100 water customers and 4,100 wastewater accounts. (*Id.*). It has owned and operated those systems since 1958. (*Id.*). As of the 1960 census, Eureka’s population was only 1,134.<sup>3</sup>

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<sup>3</sup> *Official Manual of the State of Missouri*, 1963-1964, p. 1469.

Eureka's water system includes six (6) wells, eight (8) booster pump stations, seven (7) storage tanks, and the water distribution system. (Exh. 5P, Eisenloeffel Dir., p. 4). The water distribution system includes approximately 58.8 miles of water main ranging in size from 2-inch to 12-inch, 642 fire hydrants, and associated valves and fittings. (*Id.*).

Eureka's wastewater system includes a wastewater treatment plant consisting of a three-cell aerated lagoon plant with a design flow of 2.8 million gallons per day, according to the Missouri Department of Natural Resources (MDNR) Operating Permit. (Exh. 5P, Eisenloeffel Dir., p. 4, Sched. BWE-2). The wastewater collection system includes ten (10) sewer lift stations, approximately 62.5 miles of sewer main ranging in size from 4-inch to 48-inch, and 1,452 manholes. (*Id.*).

Eureka desires to sell its water and wastewater systems. (Exh. 1, Flower Dir., p. 4). As Eureka has grown, the expertise and staffing required to run the systems has greatly increased. (*Id.*). In addition, Federal and state regulations and requirements for these systems has greatly increased in complexity and cost. (*Id.*). It has become increasingly difficult to find staffing and expertise for a system of this size, and to comply with greater regulation. (*Id.*). Eureka believes that by joining Missouri American's regional utility system it will improve the quality of Eureka's utility systems by providing the top experts in the area to run its systems, ensure compliance with all laws and regulations and allow Eureka to share in the efficiency of scale provided by joining a large utility provider. (*Id.*).

Eureka has been considering the sale of its utilities for several years. (Exh. 1, Flower Dir., p. 5). Eureka began internal conversations and analysis in 2018. (*Id.*). As a part of that process, Eureka held several town halls regarding its utilities, and a range of options have been discussed

in special meetings and normal Board meetings. (*Id.*). Mayor Flower reached out to MAWC regarding a potential sale in 2019. (*Id.*).

### ***Appraisal***

Eureka and MAWC signed a letter of intent to explore a potential acquisition in July of 2019, to include an agreement to pursue an appraisal of the systems. (Exh. 1, Flower Dir., p. 5, Sched. SMF-1). Pursuant to the procedures established in Section 393.320.3(1) of the appraisal statute, Eureka chose an appraiser, Missouri-American chose an appraiser, and a third appraiser, selected by the other appraisers, was also engaged. (*Id.* at pp. 5-6).

Mayor Flower describes the appraisal as “one of the most important parts of this process.” ((Exh. 1, Flower Dir., p. 6). Mayor Flower further explains as follows:

The Board of Alderman and [the Mayor] have a legal duty and obligation to ensure that any and all Eureka assets are sold at fair market value. Eureka staff worked extensively with the appraisers and engineers to provide detailed information regarding our system. The Board, myself, our legal team, and our consultants reviewed this appraisal information carefully before voting to put the sale to a vote of the residents. Without a fair market value sale price based on an appraisal being included in the ballot language, I do not believe there would have been enough information for the residents to approve the sale.

(*Id.*).

That appraisal was completed in March of 2020, by three appraisers certified as general appraisers under Chapter 339, RSMo. Mayor Flower believes that once a fair market value has been established for an asset, the Mayor and Board of Alderman cannot sell it for less. (Exh. 2, Flower Sur., pp. 4-5). Moreover, the residents would expect him to not sell it for less. (Tr. 61-63 (Flower)).

### ***Election***

On May 19, 2020, the Eureka Board of Aldermen passed an *Ordinance* providing notice of an election to vote on Proposition S, a question as to whether the water and wastewater utility

systems owned by Eureka should be sold. (Exh. 1, Flower Dir., p. 6, Sched. SMF-2). The specific question on the ballot was as follows:

SHALL THE CITY OF EUREKA, MISSOURI BE AUTHORIZED TO SELL ITS WATER AND WASTE WATER (SEWER) UTILITIES TO MISSOURI AMERICAN WATER COMPANY FOR THE SUM OF \$28,000,000.00 (TWENTY-EIGHT MILLION DOLLARS)?

(*Id.* at pp. 6-7).

Prior to the election, there were three (3) virtual Town Hall Meetings to discuss the proposed sale. (Exh. 1, Flower Dir., p. 7). The Town Hall Meetings were held on July 16, 2020, July 23, 2020, and July 30, 2020. (*Id.*) MAWC representatives attended the virtual Town Hall Meetings and were available to answer any questions. (*Id.*) Additionally, there were in-person meetings at the Community Center, which were also live-streamed, providing opportunities for in-person questions. (*Id.*)

The election was held on August 4, 2020, and a majority of votes cast were in favor of the sale. (Exh. 1, Flower Dir., p. 7). Proposition S garnered 2,289 yes votes (67 percent) to 1,127 no votes (33 percent). (*Id.*)

Thereafter, on November 17, 2020, MAWC entered into a *Purchase Agreement* with Eureka. (*Id.*; Exh. 5P, Eisenloeffel Dir., p. 4, Sched. BWE-1). Mayor Flower did not, and does not, believe he had any authority to enter into a contract until the voters provided that authority. (Tr. 61 (Flower)).

## **Standard**

As stated above, MAWC requests in this case certificates of convenience and necessity (“CCN”) to provide water and sewer service within the identified service area in and around Eureka, utilizing the Eureka systems.<sup>4</sup>

The Commission may grant a “water corporation” and a “sewer corporation” a CCN to operate after determining that the construction and/or operation are either "necessary or convenient for the public service."<sup>5</sup> The Commission articulated criteria to be used when evaluating applications for utility certificates of convenience and necessity in the case *In Re Intercon Gas, Inc.*, 30 Mo P.S.C. (N.S.) 554, 561 (1991). The *Intercon* case combined the standards used in several similar certificate cases and set forth the following criteria: (1) there must be a need for the service; (2) the applicant must be qualified to provide the proposed service; (3) the applicant must have the financial ability to provide the service; (4) the applicant's proposal must be economically feasible; and (5) the service must promote the public interest. The factors have also been referred to as the "*Tartan Factors*" or the "*Tartan Energy Criteria*."<sup>6</sup>

## **Assessment of Tartan Factors**

There is a need for the service as residents in and around Eureka currently make use of the existing water and sewer systems.

MAWC is qualified to provide the service as it already provides safe, adequate and compliant water service to over 470,000 Missouri customers, and sewer service to over 15,000 Missouri customers. (Exh. 5P, Eisenloeffel Dir., p. 5). This includes experience operating more than 70 wastewater systems across the state of Missouri. (Exh. 7, Kaiser Dir., p. 10).

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<sup>4</sup> See *Partial Stipulation and Agreement*, filed January 14, 2022.

<sup>5</sup> Section 393.170.3, RSMo.

<sup>6</sup> See Report and Order, *In re Application of Tartan Energy Company, L.C., d/b/a Southern Missouri Gas Company, for a Certificate of Convenience and Necessity*, Case No. GA-94-127, 3 Mo. P.S.C. 3d 173 (September 16, 1994).

In 2020, MAWC was ranked the second highest in the Midwest for customer service among water utilities by J. D. Power. MAWC's parent, American Water Works Company, consistently ranks in the top quartile of independent customer service surveys when compared to other utilities. (Exh. 5P, Eisenloeffel, Dir., p. 6). MAWC's four St. Louis water plants have participated in the Partnership for Safe Water for 18 years or longer. (*Id.*). This program is sponsored by the American Water Works Association, the United States Environmental Protection Agency, as well as other organizations to recognize commitment to superior water quality. (*Id.*). Less than 2% of surface water systems participate in the Partnership program. (*Id.*).

The grant of the requested CCNs (and approval of the underlying transaction) will result in the provision of regulated water and sewer service to the current and future residents of the service area. (Exh. 5P, Eisenloeffel Dir., p. 8). The water and sewer assets of Eureka would be acquired by MAWC, a Missouri public utility, and be subject to the jurisdiction of the Commission. (*Id.*). MAWC has considerable expertise and experience in providing water and sewer utility services to residents of the State of Missouri and is fully qualified, in all respects, to own, operate and improve the water and sewer systems currently being operated in and around Eureka. (*Id.*). Moreover, MAWC has the experience and resources to address the new permit limits that will impact the Eureka wastewater plant when the current permit expires and to address the aesthetic issues identified by residents. (*Id.*).



## Public Interest

The Commission has indicated that positive findings with respect to the other four standards above will in most instances support a finding that an application for a CCN will promote the public interest.<sup>7</sup> Thus, under that approach, the public interest is satisfied.

Mayor Flower describes the promotion of the public interest as follows:

This sale will ensure that the Eureka area sanitary sewer and water system is owned, managed, and operated by the best qualified operator and personnel in the area, and it brings in approximately 4,100 new water and 4,100 new sewer customers who can also share the cost of maintenance, improvements, and overhead with the existing customers in the system.

(Exh. 1, Flower Dir., pp. 7-8).

Additionally, the Mayor notes as follows:

Eureka residents will receive improved water and sewer services, reduce the cost of their city government, and enjoy improved streets and other infrastructure as Eureka invests the sale proceeds into other needed public improvements. The Eureka system will have increased resources, staff and expertise available to maintain and operate the systems and keep them in compliance with environmental and other regulatory requirements. Over time, I believe water quality will also be improved. The City will reduce its overhead (less staff required), which will lower the operating cost of the City on residents, and allow the City to invest in needed public improvements.

(Exh. 1, Flower Dir., p. 8. *See also* Exh. 7, Kaiser Dir., p. 11).

Adding customers to the MAWC system enables the Company to spread operating costs across a wider base. (Exh. 11, LaGrand Dir., pp. 7). Therefore, by adding additional customers, MAWC's customers as a whole recognize greater economies of scale. (*Id.*) This allows the impacts of operating costs and investments to be distributed over a broader customer base. (*Id.* at pp. 7-8).

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<sup>7</sup> See Report and Order, *In re Application of Tartan Energy Company, L.C., d/b/a Southern Missouri Gas Company, for a Certificate of Convenience and Necessity*, Case No. GA-94-127, 3 Mo. P.S.C. 3d 173 (September 16, 1994).

Certain operating costs are incurred regardless of the number of customers served, water produced or delivered, or gallons of wastewater treated. (*Id.* At p. 8). These costs would then be spread over a greater base, lowering the per unit or per customer costs for everyone. (*Id.*). Additionally, MAWC has access to some of the top chemists and scientists to test and treat the water system. (*Id.*). An acquired system has access to those capabilities whereas before the acquisition they likely would not. (*Id.*).

More specifically, existing customers will benefit from operational changes. The existing treatment and distribution system within St. Louis County has the capacity to absorb the demand of the Eureka customers with little modification, due in large part to the existing storage capacity within the Eureka system. (Exh. 7, Kaiser Dir., p. 11). This will result in a more cost-effective use of the St. Louis County treatment and distribution system investments and operations. (*Id.*).

Staff argues in the Memorandum that is a part of Mr. Gateley's Testimony ". . . that the transaction as requested by MAWC in its Application, i.e., utilizing the appraisal method contained in [Section] 393.320, RSMo, is not in the public interest." (Exh. 101, Gateley Dir., Sched. CBG-r2, p. 29 of 42) (emphasis added).

The Commission has stated, in part, as follows as to the "public interest":

The public interest is found in the positive, well-defined expression of the settled will of the people of the state or nation, as an organized body politic, which expression must be looked for and found in the Constitution, statutes, or judicial decisions of the state or nation, and not in the varying personal opinions and whims of judges or courts, charged with the interpretation and declaration of the established law, as to what they themselves believe to be the demands or interests of the public.<sup>8</sup>

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<sup>8</sup> *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc.*, Report and Order, Case No. EM-2007-0374, 2008 Mo. PSC LEXIS 693, 458-459 (MoPSC July 1, 2008).

In this situation, the public interest has been expressed through statute – that being Section 393.320, the appraisal statute. Utilizing Section 393.320 cannot be contrary to the public interest.

The factors for granting a CCN to MAWC in this case have been satisfied and it is in the public's interest for MAWC to provide water and sewer service to the customers currently served by Eureka. Further, MAWC possesses the necessary technical, managerial, and financial capacity to operate and improve the water and sewer system it wishes to purchase from Eureka.

Eureka and its citizens have shown their desire to sell the water and sewer systems to MAWC. (Exh. 5P, Eisenloeffel Dir., p. 8). The Company has expertise in providing both water and sewer services. (*Id.*). The citizens of Eureka voted to sell to MAWC, and it can efficiently and affordably provide critical water and wastewater services. Because MAWC is regionalized, particularly in St. Louis County, it can provide economies of scale and a high level of efficiency. (*Id.*). The Company's nationwide affiliations and mass purchasing power gives it the ability to gain significant savings on necessary equipment. (*Id.* at pp. 8-9). MAWC has the workforce resources available to improve and maintain the Eureka water and sewer systems and provide quality customer service. (*Id.* at p. 9).

Eureka, MAWC, and the majority of residents voting in Eureka believe this acquisition will benefit the residents of Eureka from both the capacity and capability of MAWC to effectively manage the systems and from Eureka's ability to effectively convert these assets into other community benefits. (Exh. 7, Kaiser Dir., p. 11).

The proposed transaction is in the public interest and the Commission should authorize the transfer of assets and grant MAWC the requested CCNs to provide water and sewer service within the proposed service area.

## ISSUE 2 - Conditions

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

- A. What conditions, if any, should the Commission impose? and,*
- B. Of which existing service areas should the Eureka water and wastewater systems become a part?*

### Staff Conditions

MAWC has no objection to the conditions proposed by the Staff. (See Gateley Reb., Sched. CBG-r2, p. 29-31).

### Service Areas

Section 393.320.6 requires that the Commission identify which existing service area the small water utility should become a part. (Ext. 11, LaGrand Dir., p. 8). MAWC takes the position that Eureka's now approximately 4,100 water customers should be added to the "St. Louis County" customer base of approximately 343,000 customers. (*Id.*). On the sewer side, Eureka's approximately 4,100 customers should join the "Other Missouri" sewer rate category of approximately 8,500 customers.<sup>9</sup> (*Id.*).

## ISSUE 3 – Section 393.320, RSMo

*Does Section 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?*

### Section 393.320

Section 393.320 is a statute adopted by the Missouri General Assembly establishing a streamlined process concerning the acquisition of smaller water or wastewater utilities by large water or wastewater public utilities. (Exh. 11, LaGrand Dir., pp. 5-6). Section 393.320 applies where the buyer (MAWC) is a "Large Water Public Utility," that provides safe and adequate service, and the seller (Eureka) is a "Small Water Utility." There is no dispute in this case that

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<sup>9</sup> MAWC serves approximately 15,000 sewer customers state-wide.

MAWC's and Eureka's water and sewer systems separately qualify. (*Id.* at p. 6; Tr. 256-257 (Gateley)).

### **Commission Actions**

When chosen, the use of the appraisal is mandatory, not discretionary, under the provisions of Section 393.320. The statute requires, in part, as follows:

**2. The procedures contained in this section may be chosen by a large water public utility, and if so chosen shall be used by the public service commission to establish the ratemaking rate base of a small water utility during an acquisition.**

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**5. (1) The lesser of the purchase price or the appraised value, together with the reasonable and prudent transaction, closing, and transition costs incurred by the large water public utility, shall constitute the ratemaking rate base for the small water utility as acquired by the acquiring large water public utility; provided, however, that if the small water utility is a public utility subject to chapter 386 and the small water utility completed a rate case prior to the acquisition, the public service commission may select as the ratemaking rate base for the small water utility as acquired by the acquiring large water public utility a ratemaking rate base in between. . . .**

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**8. This section is intended for the specific and unique purpose of determining the ratemaking rate base of small water utilities and shall be exclusively applied to large water public utilities in the acquisition of a small water utility.**

(emphasis added).

MAWC has chosen use of the Section 393.320 procedures. Accordingly, the statute then requires that these procedures "shall be used" by the Commission.

### **Appraiser Qualifications and the Appraisal**

One appraiser was appointed by Eureka; one was appointed by MAWC; and the third was appointed by the first two appraisers. (Exh. 11, LaGrand Dir., p. 6). The three appraisers were Joseph E. Batis, CRE, MAI; Edward W. Dinan, CRE, MAI; and Elizabeth Goodman-Schneider, ASA. (Exh. 3, Batis Dir., pp. 3-4). Each of the appraisers is a disinterested person who is a

certified general appraiser under Chapter 339 of the Missouri Code, holding the Real Estate Appraiser – General Certification. (*Id.* at p. 4; Exh. 4, Batis Sur., p. 5).

The three appraisers that participated in the Eureka valuation assignment collectively have extensive experience in the valuation of water and wastewater utility systems. (Exh. 3, Batis Dir., p. 7). They are individually and collectively well-qualified, experienced in all types of valuation assignments, and have extensive training in Uniform Standards of Professional Appraisal Practice (“USPAP”) (mandatory participation in USPAP and USPAP update educational offerings). (Exh. 4, Batis Sur., p. 6). Their individual and collective experiences include providing appraisal and/or valuation consulting services for buyers and sellers in multiple states and for valuation assignments that required similar state regulatory requirements mandating appraisal services that comport with USPAP. (Exh. 3, Batis Dir., p. 7).

Mr. Dinan and Mr. Batis hold the MAI designation from the Appraisal Institute and Ms. Goodman-Schneider holds the ASA certification (Machinery and Technical Specialties – Public Utilities. (Exh. 4, Batis Sur., p. 5). Mr. Dinan holds the designation of Counselor of Real Estate of the National Association of Realtors – which is available by invitation only. (*Id.*). Mr. Batis also holds the AI-GRS designation from the Appraisal Institute. (*Id.*). The AI-GRS designation is conferred upon members of the Appraisal Institute that have demonstrated, through experience and education, a proficiency in the area of developing appraisal reviews. (*Id.* at pp. 5-6).

Mr. Batis has also developed and presented a seminar for professional real estate appraisers on the fundamentals and methodology for appraising water and wastewater utility systems. (Exh. 4, Batis Sur., p. 6). The methodology employed for the Eureka appraisal is consistent with the seminar material that Mr. Batis developed and presented for professional

appraisers in the State of Missouri. (*Id.*) The seminar was approved by Missouri for continuing education hours for professional, state-certified real estate appraisers. (*Id.*).

No other evidence of the fair market value of the water and sewer systems was provided. (Tr. 257 (Gateley)). No other testimony from a certified appraiser was presented by Staff. (*Id.* (Gateley)). Accordingly, Staff offered no alternative valid appraisal, or Appraisal Review. (Exh. 4, Batis Sur., pp.4-5).

The work on the assignment began on August 20, 2019, when the three appraisers received documents related to the systems. (Exh. 3, Batis Dir., p. 5). The three appraisers reviewed the documents provided for the assignment and inspected the subject property facilities. (*Id.*).

Kelly Simpson, of Flinn Engineering, was hired by the appraisers to provide a high-level review of the condition of the systems, estimate the 2019 installation cost, and estimate the depreciated book value of the assets, based on the 2019 estimated installation cost and the estimated age of the assets. (Exh. 9, Simpson Dir., pp. 4-5; Tr. 203-204 (Simpson)).

The “high level review” was based on a scale of excellent, very good, good, fair and poor. (Tr. 205 (Simpson)). That scale is the rough equivalent of the grading scale A through F, respectively. (*Id.*).

Ms. Simpson observed photographs of the appearance of the above ground assets (Exh. 301). She also had knowledge of the installation dates of those above-ground assets. (Tr. 206 (Simpson)). Some of those assets were older and in fair and poor condition, while some assets were newer and in very good condition. (*Id.*). With this information, Ms. Simpson gave Eureka a “C”. (*Id.* at 205, 206).

Once the appraisers received the report prepared by Flinn Engineering, they consulted as a group, completed their research and analysis, and communicated their opinions in an appraisal report dated January 20, 2020. (*Id.*). (Exh. 3, Batis Dir., p. 5).

Subsequently, on March 16, 2020, the appraisers received an updated report from Flinn Engineering (“the Flinn Report”). (Exh. 3, Batis Dir., p. 5). The significant change from the January report to the March report was the assumed age of buried infrastructure. (Exh. 9, Simpson Dir., p. 7; Tr. 209-211 (Simpson)). The January report was based on an assumption that 70% of buried assets were installed when portions of the systems were placed in service, and that 5% was installed with the installation of each well (water distribution) and lift station (sewer). (*Id.*).

Subsequently, Ms. Simpson was made aware of the existence of certain GIS data maintained by St. Louis County that was relevant to the age of buried infrastructure. (Exh. 9, Simpson Dir., p. 7; Tr. 209-211 (Simpson)). Using the GIS data is a significantly more accurate and appropriate method of estimating the age of assets. (Exh. 9, Simpson Dir., p. 7). As described in the March report on page 3, it was:

*. . . assumed the distribution system was expanded with the addition of each well. The quantity of distribution assets was prorated based on the approximate amount of new buildings in the period between well installations. The St. Louis County GIS parcel data includes the year each building was built. The data was queried for buildings within the municipality of Eureka. The data included 3,925 parcels, which is consistent with the number of customers (3,947).<sup>10</sup>*

(*Id.*; *Id.* at Sched. KES-1).

As further described in the March report on page 5, it was “assumed the sewer system was expanded with the installation of lift stations. The percentage of assets per period were

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<sup>10</sup> The number of customers in 2019.



assumed to be similar to the calculation described above for the water distribution assets.” (*Id.*; *Id.* at Sched. KES-1).

As a result of the revised findings and conclusions in the Flinn Report, the three appraisers consulted with each other and concluded that it was appropriate and necessary to revise their January 2020 appraisal report. (Exh. 3, Batis Dir., p. 5). This revision in accordance with their professional obligations mandated by USPAP, reflects the most current, relevant, and accurate information. (*Id.* at p. 6).

The appraisers’ work was completed with the completion of the Valuation Report on March 23, 2020, and its delivery to the City Administrator of Eureka. (Exh. 3, Batis Dir., p. 6).

The Valuation Report provides an opinion of value for the subject property system/assets “as is” as of March 18, 2020 (the effective date of value for the appraisal assignment). (Exh. 3, Batis Dir., p. 10). The appraisal opinion presented in the Eureka report is not based upon future or speculative changes, additions, modifications, etc. (*Id.*). In fact, it is improper and misleading for an appraiser to assume the occurrence of some act, event, or change in the future, rather than developing a market value opinion as the property is known to exist as of the date of valuation. (*Id.* at p. 11).

The Valuation Report opines that the market value of the water delivery system is \$18,000,000, and the market value of the wastewater collection system is \$10,000,000. (Exh. 3, Batis Dir., p. 6; Sched. JEB-2).

The Valuation Report was prepared in conformance with Standards Rule 2-2(a) of the 2020-2021 Edition of the Uniform Standards of Professional Appraisal Practice (“USPAP”). (Exh. 3, Batis Dir., p. 6). In addition to being prepared in compliance with USPAP, the

Valuation Report was prepared in accordance with the Code of Ethics and Standards of Professional Practice of the Appraisal Institute. (*Id.*)

By design, USPAP provides the general framework for an appraiser's conduct but leaves the ultimate decisions and discretion to the appraiser regarding the application of the approaches to value, the scope of work decisions that impact the extent and type of research and analysis, and ultimately the development of the report communicating the opinion(s) of the appraiser. (*Id.* at pp. 5-6).

Based upon the extensive experience of the three appraisers and considering the intended users and the intended use of the subject assignment, the final Valuation Report sufficiently meets or exceeds "the expectations of parties who are regularly intended users for similar assignments," as mandated by USPAP and the appraisal licensing board of the State of Missouri. (Exh. 3, Batis Dir., p. 8).

In summary, each appraiser is disinterested and is certified as a general appraiser under Chapter 339 of the Missouri Code. (Exh. 11, LaGrand Dir., p. 6). The appraisers prepared an appraisal of the fair market value of the water system and the sewer system. (*Id.*) They returned the appraisal in writing to MAWC and Eureka in a reasonably timely manner, and their written appraisal was signed by at least two of the appraisers (in this case, all three). (*Id.*) Accordingly, Section 393.320 provides that the appraisal "constitutes a good and valid appraisal." (*Id.*)

### **Net Book Value**

MAWC previously used Section 393.320 as a part of its purchases of systems in Orrick, Garden City and Lawson, Missouri. (Tr. 257 (Gateley)). The appraisals conducted in those cases were performed using the same methods as those utilized in this case. Staff's argument that Eureka is different is based primarily on the difference between the fair market value, as assessed

by the appraisers, and what Staff believes the net book value of the systems would be, if the Eureka systems were regulated. (*Id.*). It is no surprise that these things are different. As explained below, net book value has no applicability to a municipal system. Thus, Section 393.320 addresses that by providing a measure that can be produced – an appraisal.

Net book value consists of the property's original cost less accumulated depreciation (and contributions in aid of construction). (Tr. 274 (McMellen)). Fair market value of a good or service can be defined as the price that a seller is willing to accept, and a buyer is willing to pay on the open market in an arm's length transaction. (Tr. 275 (McMellen)). These are two completely different things.

The use of a fair market value in this situation is required by Section 393.320. Municipal systems, such as those of Eureka, have no “net book value” as that term is used by the Commission. (Exh. 12, LaGrand Sur., p. 3). Municipalities are not required to maintain books and records in accordance with the Uniform System of Accounts, and Eureka has not so maintained its books in that fashion. (Tr, 273 (McMellen)).

MAWC provided two examples of this difference that are specific to Eureka in the Surrebuttal Testimony of Brian LaGrand. First, Eureka does not capitalize and depreciate utility plant investments as an investor-owned utility would. (Exh. 12, LaGrand Sur., p. 4). Per the City’s June 30, 2020, Audited Financial Statements:

Capital outlays of the various funds are recorded as expenditures when incurred. These capital outlays represent the cost of land, buildings and improvements, and furniture and equipment. The City does not maintain a record of its capital assets for depreciation purposes.<sup>11</sup>

(*Id.*). In other words, Eureka expenses, and does not capitalize, plant investments. It also has no applicable depreciation. (*Id.*).

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<sup>11</sup> June 30, 2020, Audit of Financial Statements, page 27, subpart F.

Second, because Eureka does not capitalize plant investments, other types of costs that an investor-owned utility would capitalize in accordance with the Uniform System of Accounts (USOA) are also expensed. (Exh. 12, LaGrand Sur., p. 4). These would include items such as allowance for funds used during construction (AFUDC), labor for municipal employees working on capital projects, capitalized overheads, and other costs associated with capital project planning and execution. (*Id.*). Other items that would be capitalized by an investor-owned utility may simply be recorded as maintenance expense by Eureka and would never be captured in an attempt to re-create the “net book value” of utility assets. (*Id.*).

The failure to include these items would cause Staff’s “net book value” calculation to be understated, perhaps significantly. (Exh. 12, LaGrand Sur., p. 4).

Moreover, a municipality does not account for “contributed property” as a regulated utility would be required to do. (Exh. 12, LaGrand Sur., p. 5). That is because, regardless of its origin, any utility asset that is in service has value to Eureka. (*Id.*).

In this case, Staff’s estimate of net book value included hypothetical depreciation and contributed property. (Exh. 12, LaGrand Sur., p. 5). Further, Staff’s estimate did not include the value of land and easements. (*Id.* at pp. 5-6).

Staff witness McMellen agreed that in this case Staff considered \$2,901,918 of Eureka water system plant to have been contributed. (Tr. 277-278 (McMellen); *See also* Exh. 101, Gateley Reb., Sched. CBG-r2, p. 21 of 42). This served as a \$2,901,918 subtraction from the plant in service in Staff’s net book value. (Tr. 278 (McMellen)). This subtraction concerned the Arbors development, which Ms. McMellen thinks is a fairly recent development, and left that infrastructure, owned by Eureka, which is currently in service and used and useful for the

provision of water service to Eureka residents, at zero dollars for purposes of Staff's net book value. (Tr. 278-279 (McMellen)).

Similarly, plant owned by Eureka that is considered to be fully depreciated, but which is still in service and providing service to Eureka residents, would also be considered to have a value of zero dollars for purposes of Staff's net book value estimate. (Tr. 279-280 (McMellen)). The depreciation Staff assumed included a reduction in water plant of over \$5.9 million and a reduction to sewer plant of over \$3.9 million, in its net book value estimate. Tr. 280 (McMellen); *See also* Exh. 101, Gateley Reb., Sched. CBG-r2, p. 21 of 42).

The accounting performed by municipal systems, water districts, sewer districts, and privately owned utilities that are not public utilities, is far different from that utilized before the Commission, which makes the determination of a "net book value," extremely difficult, if not impossible, to determine for those entities. (Exh. 12, LaGrand Sur., p. 7). Further, the assumption made by Staff in deriving its estimate of net book value show that the concept of net book value and fair market value are so different that it is no surprise that they would diverge in a significant fashion.

### **Ratemaking Rate Base**

In accordance with Section 393.320.5(1), the lesser of the purchase price or the appraised value, together with the reasonable and prudent transaction, closing and transition costs incurred by MAWC "shall" constitute the ratemaking rate base for the Eureka system being acquired by MAWC. (Exh. 11, LaGrand Dir., p. 7).

In this case, the purchase price (which was *specifically identified* in the public election held in Eureka) is equal to the appraised value. That amount together with the reasonable and prudent transaction, closing, and transition costs incurred by MAWC shall be used by the public

service commission and shall constitute the ratemaking rate base.

MAWC asks the Commission to set the ratemaking rate base for the Eureka water system at \$18,000,000, and ratemaking rate base for the Eureka sewer system at \$10,000,000, plus the reasonable and prudent transaction, closing, and transition costs incurred by MAWC, as called for by Section 393.320.

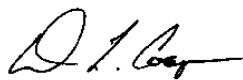
## **CONCLUSION**

For the reasons stated herein, the Commission should grant MAWC certificates of convenience and necessity to provide water and wastewater service within the proposed service area, subject to the conditions described by Staff, and establish the ratemaking rate base for the systems acquired at amounts equal to the fair market value.

**WHEREFORE**, Missouri-American respectfully requests the Commission consider its

*Initial Brief.*

Respectfully submitted,



Dean L. Cooper  
Jesse W. Craig  
BRYDON, SWEARENGEN & ENGLAND P.C.  
312 East Capitol Avenue  
P.O. Box 456  
Jefferson City, MO 65102-0456  
Telephone: (573) 635-7166  
[dcooper@brydonlaw.com](mailto:dcooper@brydonlaw.com)

Mo. Bar 36592

Mo. Bar 71850

Timothy W. Luft, MBE #40506  
Corporate Counsel  
**MISSOURI-AMERICAN WATER COMPANY**  
727 Craig Road  
St. Louis, MO 63141  
(314) 996-2279 telephone  
(314) 997-2451 facsimile  
[timothy.luft@amwater.com](mailto:timothy.luft@amwater.com)

**ATTORNEYS FOR MISSOURI-AMERICAN  
WATER COMPANY**

**CERTIFICATE OF SERVICE**

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 18<sup>th</sup> day of February 2022, to:

General Counsel's Office  
[staffcounsel@psc.mo.gov](mailto:staffcounsel@psc.mo.gov)  
[Karen.Bretz@psc.mo.gov](mailto:Karen.Bretz@psc.mo.gov)

Office of the Public Counsel  
[opcservice@opc.mo.gov](mailto:opcservice@opc.mo.gov)  
[Nathan.Williams@opc.mo.gov](mailto:Nathan.Williams@opc.mo.gov)

David Linton  
[dlinton@mlklaw.com](mailto:dlinton@mlklaw.com)

