Office of the Public Counsel,	)	
Complainant,	)	
	)	
v.	)	**Case No. WC-2002-155**
	)	
Warren County Water and Sewer Company and Gary L. Smith,	)	
Respondents.	)	

Initial Brief of the Office of the Public Counsel

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July 9, 2002

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 9th day of July 2002:

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INTRODUCTION

The central issue in this case is easy for the Public Service Commission to decide: has Warren County Water and Sewer Company (Company) violated its statutory obligation to provide its customers with safe and adequate water and sewer service? The simple answer is a resounding "Yes."

The remedy for this violation is, however, slightly more complicated: Should the company be placed under the control of a receiver as provided by Sec. 393.145 RSMo (2000)? The Office of the Public Counsel Public Counsel (Public Counsel) submits that the answer to that question is a qualified "Yes." The qualification the Public Counsel proposes is provided in Sec. 393.145.5 RSMo, that in the best interests of the company's customers, the control of this company cannot reasonably be returned to the owner of the company, Gary L. Smith. Therefore, Public Counsel believes that the primary duties which a receiver should undertake will be (1) take those steps which are immediately necessary to provide safe and adequate service and (2) to find a buyer for the company.

Time and again, the Company failed to complete the steps reasonably necessary to provide safe and adequate water and sewer service to the Company's customers. Even after receiving approval from the Missouri Public Service Commission (Commission) to construct a water storage tower, and a permit from the Missouri Department of Natural Resources (DNR) to construct a tower, the Company failed to construct and install this tower which the

Commission determined was necessary to provide adequate water service as early in Case No. WA-96-449.

In 2001, Mr. Smith was convicted in federal district court for violating the Clean Water Act, in case number 4:01CR195, based on the determination that the Company dumped raw sewage into Incline Village Lake. The Court placed him on felony probation for that offense.

Even Mr. Smith's conviction did not induce the Company to clean up its sewer operations. The Company failed to maintain its lift station in the Shady Oaks subdivision and it overflowed, discharging untreated sewer effluent into the environment. The Company has repeatedly discharged insufficiently treated effluent into Incline Village Lake.

The Company has failed to pay its assessments to this Commission and other state agencies. Other financial obligations, including its electric bills, are kept current. The Company transferred its assets to a non-regulated affiliate without Commission approval, despite knowing that Commission approval was required. The title to assets of the utility are still held by the unregulated affiliate, which will complicate the ability of a receiver to administer the utility. This rank mismanagement must cease for the good of the customers. At the hearing, Mr. Smith testified that he was trying to sell the Company. Unfortunately, this commission rely on Mr. Smith's assertion that he is looking for a buyer for his company. This may merely be another delaying tactic. The customers need and deserve immediate relief from this company's unsafe and inadequate service. It is time for another solution.

FACTS AND PROCEDURAL HISTORY

Warren County Water and Sewer Company (Company) holds certificates of convenience and necessity to provide water service and sewer service in an area near Foristell, in Warren County, Missouri. The Company is a small water and sewer corporation, incorporated under the laws of the State of Missouri. The Company is regulated by the Commission, and also regulated by the Missouri Department of Natural Resources (DNR) and the United States Environmental Protection Agency (EPA). The Company is ultimately owned and operated by Gary L. Smith. In August 2000, the corporation was administratively dissolved for failure to comply with various filing and financial requirements of the Missouri Secretary of State. As of the date of the evidentiary hearing in this case, the company's status has not been corrected, although Mr. Smith testified that he had filled out the necessary paperwork to accomplish this change.

The Company has fewer than 1,000 customers. They receive service in Incline Village, and the Shady Oaks, Forest Green and Brandi Lynn subdivisions located in and around Warren County, Missouri. The Company provides water service to its customers through the use of a well, a standpipe and transmission and distribution mains located within the service territory. The Company provides sewer service which is intended to include treatment of sewage collected by the system at two small sewer treatment plants, located within Incline Village. The Company utilizes lift stations located in Incline Village and

the adjacent Shady Oaks subdivision to carry untreated sewage to its treatment plants.

In 1997, the Staff of the Public Service Commission (Staff), the Public Counsel and the Company agreed that the Company did not have adequate storage capacity in its water system. In that case, No. WA-96-449, the Commission approved the Company's request for authorization to borrow funds to construct and install a storage tank. The Company has failed to construct and install the tank to date.

The Company has violated numerous DNR regulations, as evidenced in part by the numerous notices from the DNR that the Company's sewer system was in violation of DNR regulations. Some of these violations created a significant public health risk.

The Company currently receives gross revenues from the operation of its water and sewer systems of approximately $164,000 per year. The Company's rates are set on a cost of service basis. Electricity and maintenance costs for the Company are components of the cost of service.

Gary Smith attempted to transfer the Company to another corporate entity controlled by Mr. Smith without authorization from the Commission. The Company has failed to keep current on its electric bills; the Company has an extremely poor customer service record; and the Company has billed customers in violation of its tariffs. Company has engaged in a number of other poor management practices, including failure to timely file reports with this Commission, the Department of Natural Resources and the Secretary of State,

and failure to timely pay required assessments and fees required to continue to operate the Company in good standing. In short, the Company's management is unwilling or unable to provide safe and adequate service to the Company's customers.

In September of 2001, Mr. Smith pled guilty in federal district court for the Eastern District of Missouri, to a felony violation of the Clean Water Act, in case number 4:01CR195. In his guilty plea, Mr. Smith admitted that in April of 2001, he "did knowingly discharge or caused to be discharged pollutants, to wit: sewage waste water, from a point source at Incline Village sewage treatment system, into the Incline Village Lake, a water of the United States, in Warren County, Missouri, without permit." [Ex.5, Sched. KKB-2.] Mr. Smith violated Title 33, USC §1311(a) and §1319(c)(2), and Title 18 USC §2, while operating one of the Company's sewer treatment plants. When Mr. Smith first learned that the EPA had determined that his Company was discharging pollutants into the Incline Village Lake, he did not respond by fixing the problem. Rather, he requested notice from the EPA investigator "in writing." (Ex. 1 at p.8.)

Mr. Smith was formally sentenced in November of 2001, and placed on one year of supervised probation. In February 2002, a petition was filed alleging that Mr. Smith violated his federal felony probation by committing a new violation of the clean water act. This violation was related to an overflowing lift station in the Shady Oaks subdivision. A hearing was held on this probation violation in March of 2002, during which the federal court received evidence related to this violation. However, Mr. Smith remains on probation.

The Company has been categorized by DNR as a chronic problem company, and has received numerous notices of violation over the course of several years.

In September of 2001, Public Counsel filed the complaint which forms the basis for this case. In that complaint, Public Counsel asked this Commission to petition the Circuit Court to appoint a receiver to assume control of the company. In the alternative, Public Counsel asked the Commission to revoke the Company's certificates of convenience and necessity and direct the Company to sell, lease or otherwise transfer all assets, including plant, to an entity capable of providing safe and adequate water and sewer service to customers in the certificated area.

In January, 2002, Public Counsel learned that an unlocked lift station in the Shady Oaks service territory was not working, causing sewage to overflow. The dangerous condition of this lift station had been previously observed by employees of the Public Counsel, and is photographically documented. [Ex. 3 at Att. BAM-1, BAM-2.] As a result, Public Counsel witnesses Bolin and Meisenheimer traveled to Shady Oaks to observe the condition of the lift station. The visit was also photographically documented, and those photographs are in evidence. Independently, the DNR, Commission Staff and U.S. EPA also visited the site, and observed the condition of the lift station, and also observed backflow from the lift station overflowing and discharging untreated sewage effluent into the waters of the United States. [Ex.1, pp. 12-13.]

The Commission conducted a local public hearing in this case on March 11, 2002. At that hearing, over two dozen customers testified regarding their complaints about the quality of the service they received from the Company. Several of the customers voiced concerns about the entanglement between the regulated utility company and Mr. Smith's unregulated construction company. Several persons testified that they felt pressured to use the construction company for utility related installation work.

The Commission held an evidentiary hearing in this case on June 3-4, 2002.

ARGUMENT

1. Warren County Water and Sewer Company has failed to provide safe and adequate service to its customers.

Warren County Water and Sewer Company is a monopoly public utility. The Commission granted this company a certificate of convenience and necessity to provide water and sewer service in the certificated area. In exchange for the privilege of operating as a monopoly provider of utility service, the Company incurred the statutory obligation to provide its customers with safe and adequate service at just and reasonable rates. Sec. 393.130.1 RSMo (2000). The Company violated its statutory obligation.

The purpose of the Public Service Commission law is "to protect the consumer against the natural monopoly of a public utility, as provider of a public necessity, May Dept. Stores Co. v. Union Electric Light & Power Co., 107 S.W.2d 41, 48 (1937), while at the same time permitting a recovery by the utility of a just

and reasonable return." State ex rel. Utility Consumers Council of Missouri, Inc. (UCCM) v. Public Service Commission**,** 585 S.W.2d 41, 47 (9179).

> Section 393.140 RSMo gives the Commission authority to
>
> "supervise, among other things, the quality of production and of service; to order improvements and to set standards; to investigate the methods and inspect the facilities of the utilities; and to require the filing of a verified annual report on the financial situation and physical condition of the company" among other things. State ex. rel. UCCM, 585 S.W.2d, at 48.

The Company owes a "duty to exercise reasonable care" to its customers. See, National Food Stores, Inc. v. Union Electric Company, 494 S.W.2d 379, 384 (Mo. App. E.D. 1973). The manner in which the Company, through inaction, has failed to maintain and improve its water and sewer systems violates that duty.

A. Lack of safe and adequate water service.

In 1996, the Company commissioned a study by MECO Engineering. That study is discussed by Public Counsel witness Bolin in her Direct Testimony at pp. 6-8. The study is attached to Ms. Bolin's Direct Testimony as Schedule KKB-5. The engineering company concluded that the existing water system was inadequate to meet the needs of the Company's service territory at a time when Incline Village, the fastest growing and largest component of the service territory, included approximately 170 homes. As of the end of the year 2000, the Company reported to the Commission that it served approximately 325 residential customers. [Ex. 5, Bolin Dir. p. 6.] Based on the consensus that additional water storage was needed on the system, and Commission approval

to construct a water storage tower. However, the Company failed to construct and install such storage.

As a result of the Company's inaction in this respect, customers have suffered adverse consequences. Uneven water pressure, uneven chlorinating practices and other issues related to drinking water are related to the lack of appropriate storage on the system. [See, e.g., March 11, 2002, Tr. at pp. 56, 58, 60, 65.]

Staff witness James Mercies testified that he believed that the Company needed to place additional storage on the system as early as the mid 1990s. [Ex. 10 at p. 10.]

The system still lacks the additional storage it needed in 1996, even though the Company's customer base has nearly doubled since the MECO[1] report was completed. Company witness Smith testified that legal action by the Incline Village Board of Trustees prevented him from being able to move forward on his plan for the water storage tower. However, on September 25, 1997, Judge Hodge of the Warren County Circuit Court[2] issued a condemnation order in favor of Warren County Water and Sewer Company, and denied a request by the Board of Trustees of Incline Village for an injunction regarding the condition of the lots which were condemned to the public use of the utility. [Ex. 5, Sched. KKB-3, p. 95.] Following this Court decision, the Board of Trustees and Warren County Water and Sewer both became signatories to the unanimous Stipulation

[1] After receiving Commission approval to construct this tank, based in part on this report, the Company disputed the bill with MECO, and MECO eventually obtained a judgment against the Company which because a lien against company assets. [Tr. at pp. 270-271.]
[2] Cause No. CV597-134CC

and Agreement in Commission Case No WA-96-449. The agreement provided, in relevant part, that

> "34. The Trustees agree that they will not oppose, directly or indirectly, the request for financing of the elevated storage tank…
> 35. Furthermore, the Trustees agree that they will not oppose, directly or indirectly, any of Incline's applications for permits related to the construction, erection and operation of the elevated water storage tank." [Ex. 5, Sched. KKB-5, p.92.]

Mr. Smith finally admitted at the hearing that the Board of Trustees took no legal action to prevent the Company from installing the water tower after 1998.

In addition to the storage problems with the water system, the Company has failed to comply with some very basic requirements of being a water provider in Missouri. A clear example of this is the requirement that drinking water systems collect a primacy fee from their customers, and remit that fee to the Missouri DNR.

Public Counsel witness Daniel Daugherty, an Environmental Specialist for the DNR, described the legal requirements regarding the primacy fee. As Mr. Daugherty stated the primacy fee "isn't charged the utility directly…it's actually charged the customers of the water system….[which] is to collect the fees and then remit those back to the department." [Ex. 8, p. 13.] Witness Daugherty further testified that the Company last paid the primacy fee for the year 1998, and that DNR had not received payment for 1999, 2000 or 2001. [Id.]

The Company did not follow through on plans to build necessary storage capacity. It does not comply with DNR requirements. It is not providing safe and adequate water service to his customers.

B. Lack of safe and adequate sewer service.

The Company has repeatedly violated public safety regulations promulgated by the Commission, the DNR and the EPA. These violations constitute a violation of the Respondents' statutory duty to provide safe and adequate service. It appears that the Company management even failed to take the time to discover its legal obligations.

Mr. Smith, the owner and manager of the Company, was convicted of violating the Clean Water Act (33 U.S.C. Sec. 1251 *et seq.*) in the federal District Court for Eastern Missouri [Ex. 17, pp. 1-5] for discharging sewage into Incline Village Lake. [Ex. 2, Schedule KKB-2]. According to the testimony of witness Vic Muschler, a special agent for the United States EPA, he began investigating the company's sewer operations after receiving a complaint in June 2000. [Ex. 1, p. 6.] Agent Muschler conducted an investigation into the complaint, that included surveillance of the facility. [Ex. 1, p. 7.] During that investigation, in April 2001, he learned that "a discharge was occurring from a waste water treatment manhole directly into the Incline Village Lake." [Ex. 1, p. 7.] When he confirmed the discharge, he contacted Gary Smith. [Ex. 1, p. 8.] Smith's response was to "request that we send him a letter stating that. [Muschler] advised him that wasn't going to occur, that he had been verbally told about the discharge." [Id.] Following analysis of samples taken from the discharge, the case was referred to the U.S. Attorney's office for prosecution. [Ex. 1, p. 9.]

Upon conviction, Mr. Smith was placed on probation. Subsequently, Agent Muschler learned of another unlawful discharge. In January of 2002, he

received information that "a lift station operated and maintained by Gary Smith, Warren County Water and Sewer District (sic), had failed and was discharging into an unnamed tributary." [Ex. 1, p. 11.] He received notification of this by letter. [See, Ex. 17, p. 6.] The lift station in question was located in the Shady Oaks portion of the Company's service territory. [Ex. 1, p. 12.]

Upon investigation of this discharge, Agent Muschler discovered that:

> "..a lift station which services the mobile home park, which is within the jurisdiction of the Warren County Water and Sewer District (sic) and maintained by Gary Smith, was failing. In other words, it wasn't working. It was allowing the discharge of untreated sanitary sewer, which is a violation of the Clean Water Act….
>
> Subsequently we took that information and presented it to the Probation Office who filed a probation violation complaint, and a warrant was issued for Mr. Smith's arrest…
>
> Judge Webber held a hearing on the probation violation. Evidence was presented by the United States Attorney's Office. Judge Webber ruled that enough evidence had been presented to show a violation of Mr. Smith's probation had occurred, although he did not sentence Mr. Smith at that time….
>
> Judge Webber stated that he would like to allow Mr. Smith an additional sixty days to attempt to get the waste water treatment facility and the plant operating. Judge Webber did state that if there is additional violations brought to his attention, the judge's attention, by Gary Smith, he may be, Judge Webber would be derelict in his duties not to sentence Mr. Smith to jail time." [Ex. 1, pp. 11-14.]

At the evidentiary hearing, Agent Muschler informed the Commission that he had been advised of a "fish kill" at Incline Village on the Thursday prior to the evidentiary hearing, and that he was in the process of investigating that allegation. [Tr. June 3, at p. 49.] Agent Muschler testified that he went to Incline Village to investigate the allegation on Friday. [Tr. at p. 49.] When he was at the site, Agent Muschler saw a "large number" of dead fish. [Tr. at p. 50.]

Paul Mueller, an Environmental Specialist with Missouri DNR, works with the DNR "water pollution control program, public drinking water program, and solid waste program in investigation of complaints and in routine inspections." [Ex. 9, p. 4.] He has been working with Warren County Water & Sewer since August of 2000. [Ex. 9, p. 5.]

Mr. Mueller investigated the overflow of the Shady Oaks lift station in January of 2002 [beginning at Ex. 9, p. 14.] He testified that photographs which are in evidence attached to witness Barbara Meisenheimer's supplemental direct testimony are of the Shady Oaks lift station. [Ex. 9, p. 15. See also, Ex. 3, Att. BAM-2, pp. 4-5.] Mr. Mueller also took photographs, on January 15 and January 22, 2002, which are in evidence attached to the supplemental direct testimony of Kimberly Bolin. [Ex. 6, Schedule KKB-10.1 through KKB 10.16.] Mr. Mueller discussed the significance of those photographs in his surrebuttal testimony. [Ex. 9, pp. 16-23.] The photographic evidence establishes that the Shady Oaks lift station was filled to overflowing; that the station's electric control panel was missing components; that "both pumps are unoperational in the lift stations" [Ex. 9, p. 17] and that "somebody in Warren County Water and Sewer knew that the lift station had some problems" because the control panel switches were turned off. [Ex. 9, pp. 17-18.] The photographs also show untreated sewage spewing from the manhole near the inoperable lift station. [Ex. 6, Sched. KKB-10.3, KKB-10.4.] Other photos depict the electric meter and establish that no electricity was used between January 15 and January 22 to operate the lift station. [Ex. 9, pp. 22-23.]

Mr. Mueller conducted a routine inspection of the Company's wastewater facilities on May 14, 2002. At that time, he collected samples of wastewater for analysis at each of the Company's two sewer treatment plants. The results of those samples indicated that "the BOD (biochemical oxygen demand level) was out on both plants above the limits, and the non-filterable residue was above the limits on Plant No. 1. Plant No. 2 was within limits." [Tr. at p. 162.]

Mr. Mueller returned to the Company's service territory during the week prior to the evidentiary hearing to investigate a "fish kill" at Incline Village Lake near one of the treatment plants. [Tr. at p. 165.] Mr. Mueller obtained water samples from the site of the fish kill and sent them for analysis. [Tr. at p. 170.] He also conducted field tests on samples of effluent from the treatment plant and water from the bay containing the dead fish. He discovered "very high pH and very high ammonia" in both samples. [Tr. at p. 171.]

Despite written warnings and a felony conviction, the Company continues to pollute the waters of the United States with insufficiently treated wastewater. The Company's actions create a substantial risk to the public health. This is not safe and adequate service.

C. Justness and reasonableness of rates.

The Company has attempted to suggest to the Commission that it is willing to provide safe and adequate service but has been unable to do so because its rates are inadequate. This red herring argument should be rejected by the Commission. What the Company really wants it to have its rates raised to

include the cost of capital improvements, on the word of the Company that the improvement will be made. [Ex. 7, Sched. KKB-20.4.]

Before a Missouri regulated utility can bill its customers for the costs of capital improvements, those improvements must be in service. They must be "used and useful." This Commission has consistently applied the "used and useful" standard to Missouri utilities regulated under Chapter 393. The "used and useful" principle was articulated by the Supreme Court of the United States in Smyth v. Ames, 169 U.S. 466 (1898). The Supreme Court subsequently stated that a utility is only entitled to a return on property used to render service, but "it is not entitled to have included [in rate base] any property not used or useful for that purpose." Denver Union Stockyard Company v. United States, 304 U.S. 470 (1937). This principle was upheld in Duquesne Light Company v. Barasch, 488 U.S. 299 (1989). In that case, the Supreme Court stated that a Pennsylvania statute applying the "used and useful standard" did not constitute a taking of utility property under the Constitution "simply because it disallows recovery of capital investments that are not 'used and useful in service to the public.'" Id. at 301. Missouri Courts have upheld the Commission's use of the "used and useful" standard.[3] The Company has presented no reason why it should be exempt from a standard the Commission uses in determining revenue requirements for utilities that it regulates.

[3] See, State ex rel. Union Electric v. Public Service Commission, 765 S.W.2d 618 (Mo. App. 1988); In State ex rel. Missouri Power & Light Company v. Public Service Commission, 669 S.W.2d 941 (Mo. App. 1984). In addition, this Commission has expressly applied the "used and useful" standard to water companies, including St. Louis County Water Co, WR-2000-844.

The Company currently bills its customers (and collects from them) over $164,000 per year in order to provide service. [Ex. 14, p. 3; Tr. p. 211.] Yet the Company regularly fails to pay its electric bills (or pays with non-sufficient funds checks). [Ex. 6, at Schedules KKB-11.1 – 11.7; Tr. at pp.252-253.] The Company regularly fails to remit the DNR primacy fee which it collects from its customers as a "flow through" amount to the Missouri DNR. [Ex. 18; Tr. at p. 151-152.]

On June 28, 2001, the Company sought a rate increase through the Commission's rate increase procedure for small utility companies, 4 CSR 240-2.200. [Ex.7, Sched. KKB-20.2.] During the Staff's audit of that request, the Staff determined that the Company's "revenue has been growing anywhere from [$]10 to 15,000 per year." [Tr. at p. 211.]

Staff witness Dana Eaves filed cross-surrebuttal testimony [Ex. 14] which was adopted at the hearing by Staff witness Bill Meyer. [Tr. at pp. 204-205.] Mr. Eaves conducted the audit of the Company pursuant to its small company rate increase request. During the course of the audit,

> "the Company did not provide paid invoices, cancelled checks or any other third party documentation related to pump repair/replacement. The Company was unable to produce adequate documentation that is spent anything on repair/replacement of pumping equipment that was expensed or capitalized during the test year examined by the Staff. The only documents provided to Staff were internal invoices from Warren County Water and Sewer to 'WCW&s' for various amounts. The Staff believes based on its review of all documentation provided by the Company that 'WCW&S' is simply an abbreviation for Warren County Water and Sewer. However, Staff could not verify payment of these invoices or otherwise substantiate their validity for ratemaking purposes." [Ex. 14, at p. 2.]

Even though it could find no documentation to support a claim that the Company had spent any funds to maintain or repair pumps on its system, the Staff included an estimated amount for maintenance in determining the cost of service in connection with the rate increase request. [Ex. 7, Sched. KKB-19.5.]

The Staff included an annual salary of $24,000 for Gary Smith in determining cost of service, although the Staff found that amount "questionable," as well as expense allowances of "$10,742 for the Company's use of Mr. Smith's personal vehicle and residence." [Ex. 14, p. 4.] The Staff expressed concern about a large number of checks (26) that were issued to Mr. Smith and affiliated companies owned by Mr. Smith for "$74,433.27 for the period 1/23/2001 thru 8/4/2001" because "the Company was unable to provide the Staff with suitable documentation that the Staff could use to support including these payments in the rate case calculations." [Id.] This information was obtained by reviewing the Company's "check register." [Tr. at p. 213.]

Mr. Smith claimed at the hearing that he was drawing a "weekly check" of "$506" for his work on behalf of the Company. [Tr. at p. 352.] He further testified that, prior to January 1, he charged the Company "$3,000 a month." for his services. [Id.] However, Mr. Smith then testified that he did not always pay himself this amount, by stating that: "Well, I might go two or three or four months not need any money or I may need $200. I think if you look at the registers,

maybe draw 200, may draw 500, may draw 1,000." [Id.][4]

Mr. Smith also claimed that, in 2001, he "actually drew about 9,000 something dollars." [Tr. at p. 353.]

The Company chose not to maintain or produce records to explain how the Company's revenues are used. The Staff of the Commission determined that, as a combined operation, the Company is over-earning, based on the information the Company provided when it sought to raise rates. If the Company's operations are broken down into water and sewer operations, the Staff audit indicated that the water service was over-collecting revenues by approximately $30,000 per year, while the sewer service could justify an increase of approximately $6,700. [Tr. at p. 214.] While a reevaluation of rates would be appropriate after additional plant is placed into service and becomes used and useful, the Company has not yet made the investment which would allow such a determination. To the extent that the rates currently in effect are not just and reasonable, it is because the Company is collecting more revenue than necessary to fulfill its revenue requirement, not less.

2. The management of Warren County Water and Sewer Company has failed to operate the company in a reasonable and prudent manner, because it has failed to keep accurate books and records and has commingled the funds of regulated and unregulated business interests, and failed to meet its financial obligations.

[4] Although Public Counsel objected to testimony of documents not in evidence, there was no definitive ruling on that motion. Neither did the Company produce the records relied on by the witness. However, these are apparently the same registers reviewed by Mr. Eaves as the source of the $74,433.27 in payments to Mr. Smith over a seven-month period.

The legion of customer complaints against this company are best represented in the testimony of the Company's customers at the local public hearing. At that hearing, the Commission heard 28 witnesses testify about the manner in which the Company conducts its business, and how customers are treated when they report problems. [See, Tr. of March 11 hearing, throughout.]

In pre-filed testimony and at the evidentiary hearing, the Commission received testimony that Mr. Smith has commingled assets of his regulated and non-regulated business operations. [Ex. 7, Sched. KKB-19.2; Ex. 10, p.9.] Mr. Smith admitted on the stand that he had "merged" "Smith & Associates into the utility and operate[d] as one combined company" after 1995. [Tr. at p. 250.] The Company did not ask the Commission to approve this change in the corporate structure. [See, Tr. p. 251.] At hearing, Mr. Smith claimed that he had prepared the paperwork to transfer the assets of the utility back into the regulated company from the unregulated company. [Tr. at p. 252.] This paperwork was not produced at the hearing.

Mr. Smith further testified that he transferred ownership of the company from on July 1, 2001, to Warren-Lincoln Investments. He did not seek Commission approval for this transaction. [Tr. at p. 271.]

The company has been derelict in submitting water and sewer samples to the DNR for testing, and the DNR has noted several monitoring violations for violating Missouri clean water regulations. [Ex. 9, pp. 8-9.] The company has attempted prevent other companies from competing with his unregulated affiliate company for customer connections to his system. [Ex. 7, Sched. KKB-15.3-15.5.]

The Company has attempted to charge customers for connection costs in violation of its tariffs, and despite extensive attempts by the Commission Staff to rectify this situation, "the Company did not follow through with the necessary action to process the case, and the revised tariffs were never approved." [Ex. 10, p.10 and Schedule 1.]

The Company has a history of failing to timely pay the necessary expenses of running a regulated utility. For example, the Staff has had "numerous" contacts with the Cuivre River Electric Cooperative "regarding unpaid electric bills." [Ex. 10, p. 9.] The Company is regularly delinquent in paying its Commission assessment. [Ex. 10, p. 9] Nonpayment of Commission assessments may violate Sec. 386.370 RSMo. [Ex. 10, p.11.] The Company is delinquent in payment of property taxes on "utility-related real estate." [Ex. 10, p. 9.] The Company has been administratively dissolved by the Missouri Secretary of State for failure to pay its assessments to that office. As of the date of the hearing, Mr. Smith had still not taken the necessary steps to rectify the corporate status of the Company, although he claimed that he had prepared the paperwork, but had not filed it. [Tr. at p. 252.] This paperwork was not produced at the hearing. Company witness Smith testified, in response to questions from the bench, that he was planning to transfer all assets back to the utility company and file for reinstatement of the Company's corporate status during the first week of June 2002. [Tr. at p. 293.] Mr. Smith further agreed that the Company would file a pleading with the commission "when those two items have been accomplished" [Id.] To date, the Company has made no such filing.

At the evidentiary hearing, Mr. Smith testified that the Company had plans to sell the Company or to hire an entity to manage the company. [Tr. at pp. 222-223.] However, Mr. Smith did not provide any documentation of ongoing activities in this regard. [Tr. at p. 233.] To date, the Company has not informed the Commission of any proposed sale.

Company witness Smith testified at the evidentiary hearing that he was attempting to obtain financing and make improvements, such as installing additional water storage, so that he could sell the company. However, he admitted that he had not taken any affirmative steps to obtain current financing or to reapply for DNR permits while the current complaint proceeding has been pending. [Tr. at p. 233.]

For every claim of mismanagement, the Company counters with a claim that the revenues, approximately $164,000 per year, are insufficient to maintain the system and comply with regulatory requirements. When confronted with the evidence that over $70,000 in checks were written to Mr. Smith or entities under his control, the Company counters that those checks were not cashed. However, if no maintenance is being done, and the checks are not being cashed by Mr. Smith, the Commission should consider why checks written to the Company's electricity provider are returned for non-sufficient funds. [Ex. 4, Sched. KKB-11.1 through 11.7.]

3. The Commission should seek the appointment of a receiver for the Company, pursuant to Section 393.145 RSMo (2000). Further, the Commission should seek a ruling from the Circuit Court that it would not

be in the best interests of the Company's customers to allow the current owner to resume management of the business. The Circuit Court should direct the receiver to find a buyer for the company.

As Staff witness James Merciel candidly states in his rebuttal testimony, the receivership option "should be a temporary measure to be used only while a plan for a permanent resolution is arranged." [Ex. 10, Merceil Rebuttal, at p. 11.] The permanent plan, supported by both Public Counsel and the Commission Staff, is, as Mr. Merciel continues, "simply alternative ownership." [Ex. 10, at p. 12.] The legal question before the Commission is how it can move from the current situation, where Mr. Smith owns and exercises complete control over the Company, to new ownership of the company.

While it would be emotionally satisfying to the customers, and procedurally simpler for the Commission, an Order which merely revoked the Company's certificate of convenience and necessity and directed Mr. Smith to sell the company's plant to another entity is legally complicated. Any satisfaction the customers derived from such a pronouncement would be short-lived, as revoking the Company's certificate could essentially result in leaving the customers without any water and sewer service at all. [Ex. 10, p. 11.]

The Commission recognizes the basic right to private property ownership guaranteed by the U.S. and Missouri Constitutions. The Fifth Amendment of the U.S. Constitution states that a person may not be "deprived of… property, without due process of law; nor shall private property be taken for public use, without just compensation." This provision applies to the States through the

Fourteenth Amendment. Similarly, Art. I, Sec. 10 the Missouri Constitution prohibits taking property without "due process of law." In addition, Art. I, Secs. 26 and 28 regarding the taking of private property for public use could come into play, and require not only just compensation, but if invoked, a "judicial" determination of whether the proposed use is, in fact, public. (Art I, Sec. 27.)

The constitutional question is not, essentially *whether* the Commission could eventually effect a change in ownership; the government can order the taking of private property for a public use, as long as the private owner is compensated. However, simply ordering the company to be sold does not guarantee anything will be done without a long and protracted court battle. Further, given the Company's history of general disregard for its obligations, it is unlikely that merely ordering the owner of the Company to cease operations and sell the utility will result in any action at all.

The appointment of a receiver is not a request to be taken lightly. However, it is the best solution the Commission has in this particular case, especially when coupled with a finding that it is not in the customers' best interest to return the company to its current management, Sec. 393.145.5 RSMo. Public Counsel believes that it is important that any receiver that is appointed would be required to continue to operate the regulated utility as a whole. It would not serve the public interest to appoint a receiver which wished to "pick and choose which parts of the service territory it would continue to serve." [Ex. 7, p. 10.]

Whether or not a receiver is appointed, the Commission should take steps to ensure that all real property and assets which should be held by the utility are legally transferred back to the utility as soon as possible.

When the Commission requests that appointment of a receiver Public Counsel submits it should also request a finding that "control and responsibility for the utility should not, in the best interests of its customers, be returned to the owners," and an order from the circuit court directing "the receiver [to] proceed to liquidate the assets of the utility in the manner provided by law?"

The record in this case demonstrates the Company is full of excuses, but appears willing to take corrective action when confronted by regulatory agencies. However, the Company rarely follows through with anything more than the bare minimum.

This case is a clear example. While the Company made a few changes in response to the original complaint, those changes were limited to things that could be observed on a routine drive through of the system. Some fences were repaired. The open and unlocked lift station in Incline Village was fenced and padlocked. These were necessary repairs. However, they did not address the serious problems which the customers experience with their drinking water, due to inadequate storage and improper chlorination practices. They did not address the unsanitary discharges of wastewater from the Company's sewer treatment plants, lift stations and manholes caused by inadequate maintenance and improper repairs.

The incident with the lift station in Shady Oaks in January, 2002, the DNR violations as late as May, 2002, and the fish kill caused by high ammonia and high pH discharges from the Company's treatment plant into Incline Village Lake less than a week before the evidentiary hearing, all occurred when the Company knew this Complaint was pending. These violations all occurred while Mr. Smith was on felony probation, when he knew that his probation could be revoked if he continued to violate the Clean Water Act. If a pending complaint and felony conviction cannot induce this Company to do what is necessary to provide safe and adequate service, it is hard to imagine what inducement would suffice.

CONCLUSION

After the easy task of determining that Warren County Water and Sewer Company has violated its statutory duty to provide safe and adequate service to its customers at just and reasonable rates, the Commission is faced with fashioning an appropriate remedy. The record clearly establishes that this Company needs new management immediately, and that the current owner is incapable of properly operating a public utility for numerous reasons. In order to avoid constitutional questions concerning whether the Commission is depriving this owner of his property, it is vital that due process be exercised in coming to a solution. The receivership provisions of Sec. 393.145 RSMo provide the due process required to remove the current management and begin the process of finding a new owner for the Company's water and sewer utility. Admittedly, the Company has created quite a tangle which will take some time for any receiver to unravel, but the process must begin somewhere. The Company's water and

sewer customers have suffered long enough; it is time to slice through the Gordian knot and give them some reason to hope that they will begin to receive safe and adequate service in the near future.

WHEREFORE, it is respectfully requested that this Commission enter an Order which:

1. Finds that Warren County Water and Sewer Company has violated its duty to provide safe and adequate service, and

2. Direct its legal counsel to petition the Circuit Court of Warren County for the appointment of a receiver pursuant to Sec. 393.145 RSMo.

3. FURTHER, that the Commission direct its counsel to seek a finding from the Circuit Court, pursuant to Sec. 393.145.5 RSMo, that "control and responsibility for the utility should not, in the best interests of its customers, be returned to the owners," and an order from the circuit court directing "the receiver [to] proceed to liquidate the assets of the utility in the manner provided by law" by selling the utility to a person or company qualified to operate a water and sewer utility in the State of Missouri.

Respectfully submitted,

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