

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

In the Matter of the Joint Application of Liberty)
Utilities (Missouri Water) LLC and The Empire)
District Electric Company for Authority for) **File No. WM-2020-0156**
Missouri Water to Acquire Empire's Water)
Franchises and Assets)

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission, through counsel, and files its *Staff Recommendation* regarding the joint application of Liberty Utilities (“Liberty Water”) and The Empire District Electric Company (“Empire”).

1. On December 27, 2019, Liberty Water and Empire jointly filed an application seeking an order authorizing Empire to sell and transfer its water utility assets to Liberty Water. Both utilities are subsidiaries of the same parent company, Liberty Utilities Co., and already share some operational capacities. The Commission directed Staff to file a recommendation by February 28, 2020.

2. On February 28, 2020, the Commission granted Staff an extension of time until March 27, 2020, to file its recommendation.

3. Pursuant to § 393.190, RSMo, no water corporation shall “sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public utility, without having first secured from the commission an order authorizing it so to do.” When deciding whether to approve a regulated entity’s request to transfer assets

pursuant to § 393.190 RSMo, the Commission must determine that the transfer is “not detrimental to the public interest.”¹

4. When considering applications proposing the transfer of the assets of existing water systems, the Commission analyzes the transferee’s Technical, Managerial, and Financial (“TMF”) criteria. As explained in the Staff *Memorandum*, attached as Appendix A, Staff’s position is that the TMF criteria will continue to be met, because the companies share the same parent company and the application requests permission only to transfer the assets from one subsidiary to another. Staff foresees no operational changes to either utility. Liberty Water will continue to have access to sufficient financial capacity. Accordingly, as more thoroughly explained in Staff’s *Memorandum*, attached hereto as Appendix A, Staff asserts that the proposed transfer of assets is not detrimental to the public interest, and Staff recommends approval with conditions described in the *Memorandum*.

5. The Commission need not hold a hearing if, after proper notice and opportunity to intervene, no party requests such a hearing. *State ex rel. Rex Deffenderfer Enterprises, Inc. v. Public Service Commission*, 776 S.W.2d 494 (Mo. App. W.D. 1989). Should no party or individual request a hearing in this matter, the Commission need not hold a hearing to allow the transfer of the water utility from Empire to Liberty Water.

WHEREFORE Staff submits this recommendation for the Commission’s information and consideration. Staff recommends that the Commission approve the transfer of Empire’s water utility assets to Liberty Water, with conditions.

¹ *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo. App. E.D. 1980); *State ex rel. City of St. Louis v. P.S.C.*, 335 Mo. 448, 459-460, 73 S.W.2d 393, 400 (Mo. banc 1934)

Respectfully submitted,

/s/ Karen E. Bretz

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CERTIFICATE OF SERVICE

I certify that copies of the foregoing have been electronically mailed to all parties and/or counsel of record on this 27th day of March, 2020.

/s/ Karen E. Bretz

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
File No. WM-2020-0156

FROM: Curt B. Gateley – Water and Sewer Department
Daronn A. Williams – Water and Sewer Department
Matthew J. Barnes – Water and Sewer Department
Andrew Harris – Water and Sewer Department
Courtney Barron – Auditing Department
Keith D. Foster – Auditing Department
Amanda C. McMellen – Auditing Department

/s/ Curt B. Gateley 03/27/20
Case Manager Date

/s/ Karen Bretz 03/27/20
Staff Counsel Date

SUBJECT: Staff’s Recommendation to Approve Merger

DATE: March 27, 2020

CASE BACKGROUND

On December 27, 2019 Liberty Utilities (Missouri Water) LLC (“Liberty Water”) and The Empire District Electric Company (“Empire”) filed a joint application for Liberty Water to acquire the water assets of Empire.

Both applicants are subsidiaries of Liberty Utilities Co., which is a subsidiary of Algonquin Power & Utilities Corp (APUC). The Commission authorized the merger of Liberty Utilities Co. and Empire on October 7, 2016, whereby Liberty Utilities Co. acquired all of Empire’s common stock. Customer service for each utility has been merged into one call center. Billing for Empire and Liberty Water customers is accomplished utilizing the same system. Empire’s website is already rebranded “Liberty Utilities Empire District”. Therefore, while this matter is a transfer of assets between two subsidiaries of Liberty Utilities Co., from a customer perspective, it is primarily a restructuring.

STAFF’S INVESTIGATION

Liberty Water serves approximately 3,000 water and/or sewer system customers in McDonald, Stone, Taney and Christian Counties in the southwest; Franklin and Jefferson Counties in the east; and Cape Girardeau County in the southeast.

Empire currently serves approximately 4,400 drinking water customers in Aurora, Marionville, and Verona in southwest Missouri.

Staff reviewed Department of Natural Resources records, and discovered no violations for Liberty Water or Empire water or sewer systems that would indicate operational compliance challenges. Commission customer complaint records were also reviewed and there were six informal complaint records over the last two years. Of these, five were billing related and one was service related. All of the complaints were appropriately resolved.

Technical, Managerial, and Financial Capacity

In studying most transfers of assets involving existing regulated water and/or sewer systems, Staff utilizes the concepts of technical, managerial, and financial capacity, or “TMF,” originally developed by the United States Environmental Protection Agency. Staff’s position in this case is that, should the Commission approve the application, the TMF criteria will continue to be met. Liberty Utilities Co. is the parent company of both of the joint applicants, and the application seeks only to transfer the affected water assets from Liberty Utilities Co.’s Empire subsidiary to its Liberty Water subsidiary. Staff foresees no operational changes to either entity as a result of this asset transfer. Further, Liberty Water, as a subsidiary of APUC, will continue to have access to sufficient financial capacity. Staff takes the position that Liberty Water continues to demonstrate adequate TMF capability, and therefore finds no detriment to the public interest associated with the transaction.

This application seeks no new Certificate of Convenience and Necessity (CCN).

Tariff and Rate Impact

In its Application, Liberty Water proposes adopting its existing rules and regulations from P.S.C. MO No. 14 for the transferred Empire water customers. However, it proposes to continue using existing Empire water rates, adopted into P.S.C. MO No. 14, until Liberty Water’s next general rate case.¹ Staff does not support this proposal. There are sufficient differences in the rules and regulations between the two sets of tariffs that Staff recommends Liberty Water adopt Empire’s currently effective tariff and work towards a consolidation in the course of Liberty Water’s next rate proceeding.

Rate Base

The Auditing Department conducted a review of plant-in-service records and expense records for the Empire water system. Attachment A shows information for the water system, projected plant-in-service and depreciation reserve balances as of December 31, 2019, with Staff’s estimated

¹ “Joint Application,” WM-2020-0156, Paragraphs 9-10.

rate base as of that date of \$8,846,603.² Staff reviewed the detailed breakdown of Empire's water system assets with associated costs, depreciation reserve balances, and depreciation rates ending December 31, 2019, provided in Liberty's response to Data Request No. 0004. These were used in developing Staff's Net Plant-in-Service shown on Attachment A. This amount is different from the net book value Liberty Water used in determining its purchase price of \$8.6 million for two reasons. First, Staff determined Net-Plant-in-Service by using December 31, 2019, total plant and depreciation reserve balances, while Liberty used total plant and depreciation reserve balances at April 30, 2019. The total increase in plant activity over the eight (8) month period was approximately \$730,000 while accumulated depreciation increased approximately \$75,000, for a net increase in plant-in service of \$655,000. Second, Liberty included Construction Work in Process and Removal Work in Process balances in computing net book value, while Staff does not recognize these as rate base items and, therefore, excluded their balances from its calculation. This represented an approximately \$404,000 decrease in rate base value. The net difference between Liberty's and Staff's valuation of rate base for the Empire systems is approximately \$251,000.

Based on Staff's review of the Empire water system information in this proceeding, Liberty Water's purchase price may be slightly below the net book value of the assets. If the Commission approves the joint applicants' request in this matter, Staff expects an updated rate base level will be necessarily established when Liberty Water files its next rate case. It has been Staff's position in prior cases that utility rates for acquired properties should be based upon the remaining net book value associated with the original cost of utility plant at the time when the plant was first devoted to public use; rate base should not reflect the amount of any acquisition adjustment, either above or below net book value. Liberty Water has not requested recovery of any acquisition premium in this proceeding.

By Commission regulations, Liberty Water should keep its financial records for utility plant-in-service and operating expenses in accordance with the National Association of Regulatory Utility Commission (NARUC) Uniform System of Accounts. Staff recommends the Commission specifically require such recordkeeping apply to the Empire water system.

Depreciation

In Case No. WR-2012-0300, the Commission ordered water depreciation rates applicable to the Empire water systems. Staff recommends Liberty Water use these water depreciation rates for the

² This rate base number simply reflects Staff's findings in a review, and is presented for information only. There has been no negotiation with other parties who might be interested in a rate base level and who might believe a different number is appropriate. Staff is not recommending that the Commission make any finding on rate base level in this case. If the Commission approves this asset transfer and Liberty Water acquires The Empire District Electric Company's water system, then Staff expects rate base level for this system will be established when Liberty Water files its next rate case.

assets proposed to be transferred from Empire. In addition to these depreciation rates, Staff also recommends Liberty Water use a depreciation rate of 6.43% for Account Number 398 Miscellaneous, which is not included in the depreciation rate schedule ordered in Case No. WR-2012-0300.

Financial Analysis

No authorization for financing approval or encumbrance of assets is sought in the application.

OTHER ISSUES

In reviewing the application, Staff also considered the effect of the asymmetrical pricing requirements of the Commission's Affiliate Transactions Rules³ on this transaction. While the Commission does not have Affiliate Transaction Rules that apply to water utilities, because Empire's water utility is a division of The Empire District Electric Company, the affiliate transaction rules for electric utilities could be argued to apply to any Empire transaction with an affiliate; even those concerning its water operations. Applying the asymmetrical pricing requirements within the affiliate transaction rules in this instance, Empire would be required to sell its water assets at the higher of its fully distributed cost or fair market price. However, the intent of the Commission's Affiliate Transaction Rules is to prevent *regulated* utilities from subsidizing their *non-regulated* operations. Staff has traditionally taken the position that the asymmetrical pricing requirements are unworkable between *regulated* affiliates. Both Liberty Water and Empire are regulated utilities. Further, the purchase price to be paid by Liberty Water was determined utilizing its determination of the net book value of the Empire water assets. Therefore, it is Staff's position that the type of transaction contemplated by this application was not intended to be governed by the Commission's Affiliate Transaction Rules, as it can be primarily characterized as a reorganization, and no subsidization of Empire's non-regulated operations is likely to occur as a result.

Liberty Water and Empire are both corporations in good standing with the Missouri Secretary of State, and each are current on annual reports and PSC assessment payments. Liberty Water has two acquisition applications pending before the Commission (WM-2020-0174 and SA-2020-0067), but these will have no impact on the merger with Empire.

STAFF'S RECOMMENDATIONS AND CONCLUSIONS

Staff has reviewed the application and data provided by the joint applicants. The nature of the transaction is a reorganization of two regulated entities owned by the same regulated parent organization. Based on its review, it is Staff's position that the proposed transaction will not cause

³ 20 CSR 4240-20.015(2).

any changes to or disruption of utility operations, and the primary difference that some ratepayers will experience is a change in the name of their utility provider. Staff recommends the Commission approve the application with the conditions and actions as outlined below:

1. Authorize Empire to transfer utility assets to Liberty Water, and transfer the CCNs currently held by Empire to Liberty Water;
2. Authorize Liberty to apply Empire's existing rates and rules on an interim basis immediately after closing on the assets, to apply to the Empire service area until an adoption notice tariff sheet becomes effective;
3. Require Empire to submit an adoption notice tariff sheet for the existing tariffs within ten (10) days after closing on the assets and as a 30-day tariff filing, for the existing Empire tariff;
4. Approve Empire's existing depreciation rates for water utility plant accounts to apply to the Empire service area assets;
5. If closing on the water system assets does not take place within thirty (30) days following the effective date of the Commission's order approving such, require Liberty and/or Empire to submit a status report within five (5) days after this thirty (30) day period regarding the status of closing, and additional status reports within five (5) days after each additional thirty (30) day period, until closing takes place, or until either Liberty or Empire determines that the transfer of the assets will not occur; and
6. Make no finding that would preclude the Commission from considering the ratemaking treatment to be afforded any matters pertaining to the granting of this merger to any later proceeding.

ATTACHMENT

- A. Net Plant In Service Worksheet

Liberty Utilities (Missouri Water) LLC / The Empire District Electric Company

File No. WM-2020-0156

Asset Valuation

Ending Balance as of December 31, 2019

Plant in Service	\$14,973,733
Depreciation Reserve	<u>\$6,127,130</u>
Net Plant in Service	<u><u>\$8,846,603</u></u>