BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

STAFF'S INITIAL BRIEF

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STAFF'S INITIAL BRIEF

COMES NOW the Staff of the Missouri Public Service Commission and, for its Initial Brief, states to the Missouri Public Service Commission as follows:

INTRODUCTION AND OVERVIEW

Warren County Water and Sewer Company is a regulated utility that holds certificates of convenience and necessity to provide water and sewer service to the Incline Village Subdivision and surrounding areas in and near Foristell, Missouri. Gary L. Smith is the sole owner of Warren County Water and Sewer Company, and was formerly doing business as Incline Village Water and Sewer Co. Warren County Water and Sewer Company and Incline Village Water and Sewer Co. will herein be interchangeably referred to as "the Company." The Company currently serves about 325 customers.

Mr. Smith is also the sole owner of Warren-Lincoln Investments, Inc. and Gary Smith and Associates, LTD, which are not regulated by the Commission.

On September 26, 2001, the Office of the Public Counsel filed two complaints against the Company, claiming that the Company is not providing safe and adequate service to its

customers, as required by law. In each of these cases, the OPC requested that the Commission petition the circuit court for the appointment of a receiver, pursuant to Section 393.145, RSMo 2000,[1] or for alternative relief, such as the revocation of the Company's certificates of convenience and necessity and an order that the Company sell all of its assets to an entity that is capable of providing safe and adequate service to the customers in the certificated area. The Commission subsequently consolidated OPC's two complaint cases.

On May 7, 2002, the parties jointly proposed a list of five issues for determination by the Commission. An evidentiary hearing was held on June 3 and 4, 2002. The Staff will address each of the five identified issues, in order, in this Initial Brief.

The record in this case clearly shows that the Company has failed to provide safe and adequate water service, because, as the Company itself acknowledges, it has failed to construct an additional water storage facility that is necessary for the health and safety of its customers. The Company has also failed to provide safe and adequate sewer service, because it has failed to properly maintain and operate its equipment and has discharged untreated sewage to the waters of the United States. Mr. Smith pleaded guilty to a federal felony charge of knowingly discharging untreated sewage to a water of the United States. Mr. Smith has also failed to operate the Company in a reasonable and prudent manner, in that he has failed to pay creditors as required, failed to comply with government requirements, failed to properly keep his books of account, commingled assets, and failed to respond to the needs and the legitimate requests of the customers of the Company.

Section 393.145 authorizes the Commission to seek the appointment of a receiver if a Company is unable or unwilling to provide safe and adequate service to its customers. The Company satisfies this requirement, because it has shown that it is unable and unwilling to

[1] All statutory references herein are to RSMo 2000, unless otherwise noted.

provide safe and adequate service, and there is no reason to suspect that it will provide safe an adequate service at any time in the foreseeable future.

The Commission should therefore seek the appointment of a receiver, on an interim basis, to manage the day-to-day operations of the Company until a suitable buyer can be found.

ARGUMENT

Issue No. 1: Has Warren County Water and Sewer Company failed to provide safe and adequate water service to its customers?

Low Water Pressure / Company's Failure to Construct Water Tower

Of the many complaints by customers of the Company about the water service provided at Incline Village, the most prominent and most common are complaints about the low water pressure in their residences. At the public hearing on March 11, 2002, customers often voiced these complaints in colorful, bitter terms. For example, one customer said that if he and his wife both took showers at the same time, you could be pretty sure that one of them would get wet.

According to Daniel Daugherty, an employee of the Missouri Department of Natural Resources ("MDNR"), the Safety Drinking Water Regulations, Rule 10 CSR 40-4.080 (9), requires that water systems maintain a minimum pressure of at least 20 pounds per square inch ("psi") in the distribution system at all times during normal operating pressures. Mr. Daugherty also testified that the houses in Incline Village that are nearest the standpipe, in terms of elevation, have difficulty maintaining the minimum pressure of 20 psi.[2] Staff witness Steve G. Loethen testified that he had installed pressure recorders on the system and obtained readings of

[2] Daugherty Surrebuttal, Exh. 8, p. 16, line 25 – p. 17, line 18.

less than 20 psi. He also noticed that the well "cycles" several times per hour, and concluded that additional storage is required.[3]

Staff witness James A. Merciel, Jr., a registered professional engineer for more than 20 years, agreed that a new storage tank is "absolutely necessary."[4] He said the water pressure is maintained by the level on the storage tank, and is often inadequate, falling below the 20 psi minimum that is required by the MDNR.[5]

Mr. Smith testified that the water pressure in the system has remained constant since 1983, and that it depends only upon the difference between the level of the water in the storage tank and the elevation of the home to which the water is delivered. He said the number of homes that are served by the systems does not affect the water pressure.[6] Mr. Merciel, however, disagreed with Mr. Smith; he said that there are hydraulic losses throughout the distribution system during periods of high flows. He also said that although the system was designed originally to provide 20 psi of pressure at all points in the system, the combination of customer growth and the resulting higher demand has resulted in pressure problems.[7] Mr. Merciel is an engineer; Mr. Smith is not. The Staff suggests that Mr. Merciel's view on this technical matter is entitled to more credibility that Mr. Smith's, and that the Commission should find that the pressure in the Company's system has decreased as the system has grown.

In addition to the water pressure issue, there are other reasons to support the construction of additional water storage capacity. The MDNR Public Drinking Water Program recommends storage volume equal to or greater than the average daily demand in the system. The average daily demand in the Company's system is currently about 66,000 gallons. The existing standpipe

[3] Loethen Rebuttal, Exh. 12, p. 7, line 15 – p. 8, line 5.
[4] Merciel Rebuttal, Exh. 10, p. 5, lines 15-17.
[5] Merciel Rebuttal, Exh. 10, p. 3, lines 7-17.
[6] Smith Rebuttal, Exh. 15, p. 13, line 18 – p. 14, line 13.

has a capacity of only 30, 500 gallons – less than half of the system's current average daily demand. Additional storage capacity is therefore necessary in case of equipment failure or during periods of extremely high water use.[8] Additional storage capacity would also enable the Company to provide fire protection.[9]

Mr. Merciel has long advocated the construction of additional storage capacity. He testified in support a new storage tank in both Case No. WA-96-449, a certificate case filed by the Company, and Warren County Circuit Court Cause No. CV597-134CC.[10]

Mr. Merciel is not alone in his belief that additional storage capacity is required. Meco Engineering Company, a consultant hired by the Company, prepared a 1996 report, in which it stated that the possibility of contamination entering the water system increases when the system pressure falls below 20 psi. Meco noted that the Company's existing system, by design, allows the water pressure to fall below 20 psi on a fairly regular basis at several homes.[11] Meco recommended that the Company construct a new storage tank with a capacity of 250,000 gallons, and with a high water line at 750 feet USGS elevation, which would provide 47.7 psi static pressure at the tank site.[12] Obviously the Company's existing system falls far short of this recommendation, which is now nearly six years old.

The Company, likewise, agreed that additional storage was needed. The Company signed a Stipulation and Agreement, which provided, in Paragraph 20, that: "The construction of an elevated 100,000 gallon water tower and storage tank (the 'Water Tower') is necessary for the health, safety and welfare of the public in the *present* service area, including the residents of the

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[7] Merciel Cross-Surrebuttal, Exh. 11, p. 4, line 4 – p. 5, line 3.
[8] Merciel Rebuttal, Exh. 10, p. 5, line 10 – p. 6, line 9.
[9] Merciel Cross-Surrebuttal, Exh. 11, p. 5, lines 4-15; Smith Rebuttal, Exh. 15, p. 16, lines 16-17.
[10] Merciel Rebuttal, Exh. 10, p. 6, lines 9-14.
[11] Bolin Direct, Exh. 5, Sch. KKB-5, p. 5.7.
[12] Bolin Direct, Exh. 5, Sch. KKB-5, pp. 5.14 - 5.15.

Incline Village subdivision."[13] The parties to that Stipulation and Agreement agreed, in Paragraph 32, that the Company's request for expansion of its certificated area should be granted if the Company took steps to construct a water tower as described.[14] On June 18, 1998, the Commission approved the Stipulation and Agreement and conditionally granted the requested certificate of authority, provided that the Company comply with Paragraph 32 of the Stipulation and Agreement.[15]

As we all know, in the four years since then, the Company has, of course, never constructed this additional water storage. This, despite the fact that all parties to this case, including the Company, as well as the Company's consultant and the MDNR, all agree that additional storage is necessary for the health, safety and welfare of the residents of the Incline Village Subdivision. This clearly establishes that the Company is not providing safe and adequate water service to its customers, and that it is unable or unwilling to provide safe and adequate water service.

Other Water Service Problems

At the local public hearing in this case, on March 11, 2002, the Company's customers voiced a number of other complaints about the water service they receive. The most common of these complaints concerned excessive levels of chlorine in the water, to the extent that it even resulted in the bleaching of clothing.

Other complaints included: rusty or discolored water; the "rotten egg" smell associated with the presence of hydrogen sulfide; chlorine smell and other odors; interruptions in service; calcium buildup and damage to household appliances; and the Company's practice of trenching

[13] Bolin Direct, Exh. 5, Sch. KKB-3, p. 88.
[14] Bolin Direct, Exh. 5, Sch. KKB-3, pp. 90-92.
[15] Bolin Direct, Exh. 5, Sch. KKB-3, p. 81.

across the roads of the subdivision when installing water lines and failing to repair its excavations.

Customers also complained about Mr. Smith's belligerent attitude and his complete failure to respond to their calls.

The Company's customers have been dissatisfied with their service for many years, and Mr. Smith has given no reason for the Commission to believe that this will change anytime soon. It appears that the Company's problems are chronic. As OPC witness Barbara A. Meisenheimer observed: "It is extremely unlikely that, without a serious change in management style, or complete change in management, the Company's customers will have reason to make fewer complaints in the future.[16]

Issue No. 2: Has Warren County Water and Sewer Company failed to provide safe and adequate sewer service to its customers?

Inadequate Security at Treatment Facilities

The Company cannot be said to provide "safe and adequate service" unless it provides, at the very least, service that is "safe." The provision of safe service in a wastewater treatment facility encompasses two concepts: there must be sufficient security, so that people and animals cannot enter the premises and harm themselves or damage the system; and the effluent that is discharged from the plant must not be harmful to human beings, wildlife or the environment. The Company fails to satisfy either of these tests.

The direct testimony and supplemental direct testimony of OPC witness Barbara A. Meisenheimer is replete with descriptions and photographs of conditions that illustrate the Company's failure to provide adequate security measures. Examples include the following: the

cover of a lift station was not adequately secured; there was an unlocked electrical box at one of the sewage treatment plants; there was debris in the vicinity of one of the treatment plants; a portion of one security fence was missing; the Shady Oaks lift station was not fenced, not covered, and the electrical box was not locked; and a gate was loose and unsecured.

As Staff witness Loethen observed: "Easy access to the treatment plant by unauthorized persons presents safety hazards including a potential health risk due to exposure to raw sewage, electric shock and drowning. There is also a risk of vandalism, which could result in unnecessary repair expense and/or a failure to properly treat the sewage."[17] Mr. Loethen also testified that he has seen lift stations without adequate fences, unlocked control panels, and unlocked wet well doors, which creates a potential health, electric shock and/or drowning hazard, and with alarm systems that are not operational.[18]

Mr. Smith responded by saying that fences "serve as a screen and are not designed for security purposes or to keep anyone out," adding that the Company repairs fences at least twice each year.[19]

Such is not the case, however. Although fences do serve as a screen, the primary purpose of the fences is for security and to keep people, especially children, and animals out, so they will not harm themselves or cause damage to the property.[20] Fencing is, in fact, required by the rules of the Clean Water Commission.[21] The purpose of this rule, according to OPC witness Daugherty, is to discourage trespass by unauthorized individuals, to protect them from injury, to

[16] Meisenheimer Surrebuttal, Exh. 4, p. 10, lines 12-14.
[17] Loethen Rebuttal, Exh. 12, p. 4, lines 12-17.
[18] Loethen Rebuttal, Exh. 12, p. 7, lines 1-7.
[19] Smith Rebuttal, Exh. 15, p. 5, lines 9-12.
[20] Loethen Rebuttal, Exh. 12, p. 2, line 5 – p. 3, line 12.
[21] 10 CSR 20-8.020 (11) (C) 11.

prevent vandalism, and to protect against possible litigation in the event that someone is injured.[22]

As is evident from the photographs and testimony presented by Ms. Meisenheimer and the testimony of Mr. Loethen and Mr. Daugherty, the Company has failed to take adequate precautions to make the sewer treatment facilities safe.

Improper Maintenance of Equipment

Mr. Loethen made annual inspections of the Company's sewer facilities on July 26, 2000, and September 5, 2001, in addition to numerous unscheduled visits to the facilities. He testified that the sewer service is inadequate, because the Company fails to properly operate and maintain its sewage treatment plants and lift stations.

The Company's sewer system has four lift stations. A rule of the Clean Water Commission[23] requires that lift stations have duplicate pumps installed and that both pumps be operational. Mr. Loethen testified that he had never seen all four lift stations fully operational at the same time. The problems he observed included lift stations with only one pump operational, controls wired incorrectly, lift stations with no "lead" and "lag" pump assigned, and alarm systems that were not functioning. When Mr. Loethen visited the site on January 29, 2002, the lift station in the Shady Oaks Subdivision was not operating at all, causing raw sewage to overflow from the manhole onto the ground and into a nearby creek.[24] Mr. Loethen concluded that "operation and maintenance of the lift stations is inadequate."[25]

[22] Daugherty Surrebuttal, Exh. 8, p. 16, lines 4-24.
[23] 10 CSR 20-8.130 (4) (C).
[24] Loethen Rebuttal, Exh. 12, p. 5, line 6 – p. 6, line 21.
[25] Loethen Rebuttal, Exh. 12, p. 6, lines 19-21.

The Company also failed to properly operate and maintain its two sewage treatment plants. A rule of the Clean Water Commission[26] requires that extended aeration facilities, such as those the Company utilizes, must have duplicate blowers and motors installed and that both are operational.

Mr. Loethen testified that when he visited the Company's facilities on February 6, 2002, Treatment Plant No. 1 did have two blowers and motors operational, but that Treatment Plant No. 2 did not. On all of his other visits to the facilities, *neither* of the treatment plants had two blowers and motors operational. They were therefore in violation of the Clean Water Commission rules most of the time.[27] Mr. Loethen reasonably concluded that "the operation and maintenance of the treatment plants is inadequate.[28]

Discharge of Untreated Sewage

One predictable result of the Company's failure to adequately operate and maintain its lift stations and sewage treatment plants is the discharge of untreated or inadequately treated sewage to the environment and to the receiving lake and streams.

OPC witness Paul E. Mueller, an employee of the MDNR, testified that wastewater flowed from the wet well of the Shady Oaks lift station out onto the ground and to a shall ditch which went to a wet weather branch of Big Creek, which is a flowing water of the United States.[29] Mr. Mueller also explained the reason why this overflow occurred, and further supported the conclusion that the Company was not properly operating and maintaining its lift stations. The needle on the electric meter did not move between January 15, 2002 and January

[26] 10 CSR 10-8.020 (13) (B) 6.
[27] Loethen Rebuttal, Exh. 12, p. 3, lines 7-20.
[28] Loethen Rebuttal, Exh. 12, p. 3, line 20 – p. 4, line 2.

22, 2002, leading Mr. Mueller to conclude that the waste water pumps did not operate at all during this one-week period of time.[30] It is no wonder that untreated sewage ran out onto the ground and to the creek!

As noted above, Mr. Loethen also observed raw sewage that had overflowed from a manhole near the Shady Oaks lift station and into a nearby creek.[31] Mr. Loethen also testified that on other occasions he observed significant amounts of sludge in the waters that receive the effluent from the two sewage treatment plants. "Sludge in the receiving stream is a good indicator that the facility is not meeting MDNR limits," he said.[32]

Sampling / Compliance Violations

The results of tests that MDNR conducted on the effluent from the sewage treatment plants provides further, objective evidence that the treatment plants have not been functioning properly.

The MDNR requires the Company to provide monthly samples from each of the wastewater plants. Treatment Plant No. 2 had violations in each of the twelve months of 2001. Treatment Plant No. 1 had violations in eight of the 12 months in 2000.[33]

OPC witness Mueller investigated complaints about wastewater bypasses, due to the failure of the Shady Oaks lift stations, in April 2001 and again in January 2002. A grab sample was taken from this effluent on January 15, 2002. The results "were far in excess of the permitted discharge limits," according to Mr. Mueller. The biochemical oxygen demand (BOD)

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[29] Mueller Surrebuttal, Exh. 9, p. 18, line 3 – p. 20, line 23, and p. 21, line 17 – p. 22, line 20. See also the photographs of this overflow, which are included as Schedules KKB-10.3 through KKB-10.10 and Schedules KKB 10.13 through KKB 10.16, attached to Bolin Supplemental Direct, Exh. 6.
[30] Mueller Surrebuttal, Exh. 9, p. 20, line 24 – p. 21, line 16.
[31] Loethen Rebuttal, Exh. 12, p. 6, lines 1-3.
[32] Loethen Cross-Surrebuttal, Exh. 12, p. 9, line 15 – p. 11, line 2.
[33] Mueller Surrebuttal, Exh. 9, p. 8, lines 13-25. It is interesting to note that Mr. Smith testified that Plant No. 1 "has been in compliance a substantial percentage of the previous 120 plus months."

of this effluent was 359 mg/l (compared to the permitted limit of 30 mg/l) and the nonfilterable residue was 112 mg/l (compared to the permitted limit of 30 mg/l). [34]

Mr. Mueller also obtained composite samples from both of these treatment plants early this year, and in both cases the results again exceeded permissible limits. On January 23, 2002, the effluent from Plant No. 1 had a BOD of 97 mg/l (compared to the permitted limit of 30 mg/l) and nonfilterable residue of 84 mg/l (compared to the permitted limit of 30 mg/l). Two weeks later, on February 7, 2002, the effluent from Plant No. 1 had a BOD of 25 mg/l (compared to the permitted limit, for this plant, of 20 mg/l) and nonfilterable residue of 27 mg/l (compared to the permitted limit, for this plant, of 20 mg/l).[35]

As a consequence, the MDNR had issued notices of violation against the Company six times in the five years before OPC witness Kimberly K. Bolin filed her direct testimony in this case.[36] The MDNR issued additional notices of violation on November 15, 2001, for discharges exceeding permissible limits, and on January 15, 2002, for bypassing wastewater from a treatment facility, failing to report the bypass, discharging contaminants into water of the state and failing to maintain and operate a wastewater facility.[37] Finally, the MDNR issued one additional notice of violation on June 20, 2002.[38]

Furthermore, Mr. Mueller also testified that the plant effluent has degraded in the past year.[39] Mr. Smith has produced no documentary or objective evidence to suggest that Mr. Mueller's conclusion is in error.

[34] Mueller Surrebuttal, Exh. 9, p. 13, line 13 – p. 14, line 12, and Deposition Exhibit 1.
[35] Mueller Surrebuttal, Exh. 9, p. 23, line 10 – p. 24, line 18, and Deposition Exhibit 2.
[36] Bolin Direct, Exh. 5, p. 4, lines 1-5.
[37] Bolin Supplement Direct, Exh. 6, p. 2, lines 7-21.
[38] See Exh. 21.
[39] Mueller Surrebuttal, Exh. 9, p. 12, lines 14-19.

From the foregoing, it is clear that the effluent from the Company's treatment plants and from the bypasses is not satisfactory, and the Company is not providing adequate service in treating this sewage.

Gary Smith's Felony Conviction

The Company's inadequate treatment of the sewage from Incline Village culminated in an indictment against Mr. Smith for the federal criminal offense of knowingly discharging sewage waste water into Incline Village Lake, a water of the United States, in violation of 33 U.S.C. 1311 (a) and 1319 (c) (2), and in Mr. Smith's conviction of that offense. Mr. Smith pleaded guilty to that charge. In his Plea Agreement and Stipulation of Facts Relative to Sentencing, he stated the following:

> 4. **ELEMENTS OF OFFENSE:** The defendant fully understands that the elements of the crime with which he has been charged and which he admits committing are as follows: 1. On or about the date charged in the indictment the defendant discharged a pollutant into a water; 2. The pollutant was discharged from a point source; 3. The water was a water of the United States; 4. The discharge was unpermitted; and 5. The defendant did so knowingly.[40]

The offense occurred during the period of April 17, 2001 to April 25, 2001, and Mr. Smith signed the plea agreement on August 16, 2001. By this plea agreement, Mr. Smith acknowledged that he discharged pollutants without permission, and that he did so knowingly. He was placed on twelve months probation for this offense in September 2001. It is hard to imagine more persuasive evidence of the fact that the Company has failed to provide adequate sewer service to the customers at Incline Village.

As serious as this offense is, it might still be forgiven, if there was evidence that it was an isolated instance, or if there were reason to believe that it will not occur again. Unfortunately, there is no such evidence. Mr. Muschler testified that he subsequently determined that a

different lift station in the Company's service area was failing, thereby allowing the discharge of untreated sanitary sewage to a water of the United States, in violation of the Clean Water Act – the very same offense of which Mr. Smith had previously pleaded guilty, and for which he was already on probation.[41]

According to OPC witness Vic E. Muschler (an employee of the U.S. Environmental Protection Agency's Criminal Investigation Division), a federal judge found that enough evidence had been presented to show that Mr. Smith had violated his probation; the judge did not, however, revoke the probation.[42] Mr. Smith, on the other hand, contends that no judge has determined that he has violated the terms of his probation.[43] This is in direct conflict with the testimony of Mr. Muschler, who was also present at the probation revocation hearing before the federal judge. The Staff submits that on this point, the Commission should find that Mr. Muschler is a more credible witness than Mr. Smith.

The Commission should determine that the Company has failed to provide, and is still failing to provide safe and adequate service to its customers in the Incline Village Subdivision.

Issue No. 3: Has the management of Warren County Water and Sewer Company failed to operate the company in a reasonable and prudent manner, such as by keeping accurate books and records and preventing commingling of regulated and unregulated business matters?

The record in this case is replete with evidence that the management of Warren County Water and Sewer Company has failed to operate the Company in a reasonable and prudent manner. In this brief, the Staff will discuss just three broad, general areas in which the Company

[40] See Bolin Direct, Exh. 5, Sch. KKB-2, pp. 2-3.
[41] Muschler Surrebuttal, Exh. 1, p. 11, line 19 – p. 13, line 4.
[42] Muschler Surrebuttal, Exh. 1, p. 13, line 20 – p. 14, line 4.

has demonstrated its poor management. Those three areas are: the Company's failure to pay its bills, taxes and fees and file reports required by government agencies; the Company's poor accounting practices, commingling of funds, and attempts to rearrange the corporate structure without the approval of the Commission; and the Company's poor relationships with its customers.

Company's Failure to Pay Taxes, Assessments, Primacy Fees, and Electric Bills, and Administrative Dissolution of Corporation

The Company has demonstrated an impressive ability to disregard its obligations to its creditors and government entities.

The corporation has been administratively dissolved for failure to file an Annual Registration Report with the Missouri Secretary of State.[44] Mr. Smith acknowledged that he had the paperwork for filing with the Secretary of State, but simply hadn't filed it yet.[45]

Mr. Smith also acknowledged that the Company had failed to pay all of its Commission assessments, although the exact amount owing is in dispute. Mr. Meyer testified that "there was about 1,600 due for 2000 fiscal year and about 3,400 for the current fiscal year, totaling approximately $5,000 outstanding right now."[46] The Company, however, claims that it only owes $1,666.36. It bases this claim on Exhibit 20, a letter from Dana K. Joyce, General Counsel of the Commission. That letter states, in part:

> In June 2001, the Commission issued orders determining the amount of assessment owed by each utility. At the end of June 2001, the Commission notified you of the amount of your assessment *for the fiscal year beginning July 1, 2001*. Payment of that amount was due on July 15, 2001, with an option for four quarterly payments due July 15th, October

[43] Tr. 362, lines 9-16.
[44] Meisenheimer Supplemental Direct, Exh. 3, p. 8, lines 18-20; Bolin Supplemental Direct, Exh. 6, p. 11, lines 9-15.
[45] Tr. 252, lines 6-8.
[46] Tr. 218, lines 13-18.

15th, January 15th and April 15th. To date, you have an unpaid annual assessment of $1,666.36. (Emphasis added).

This letter, therefore, appears to state the balance that the Company owes *for only one fiscal year*, rather than the total balance due on the Company's account, so it does not contradict Mr. Meyer's testimony. In any event, it is clear that the Company has failed to make timely payment of the full balance due.

The Company is also delinquent in the payment of primacy fees. These are small fees that the Company is required to collect, from its customers, for remittance to the MDNR. Mr. Daugherty testified that the last primacy fee that the Company paid was for 1998, and that the fees for 1999, 2000 and 2001 had not yet been received.[47] Mr. Smith disputed that statement. He said he paid the 2001 primacy fee, and that he thought he paid the others, "but they indicate I haven't." He seemed unsure of himself, though, saying that he would have to "verify that."[48] As noted, the primacy fee is not a large sum; but it represents money that never belonged to the Company, and which the Company only collected as an agent, or in essence, trustee, for the MDNR.

The Company and Warren-Lincoln Investments, Inc., (which are both 100% owned by Mr. Smith) have also failed to pay their electric bills from Cuivre River Electric Cooperative. According to Kevin L. Hurd, Manager of Branch Offices for Cuivre River, the total balance due on those accounts, as of February 11, 2002, was $6,496.[49] Mr. Smith acknowledged that he'd "had some problems with [his] electric bill," and that he had attempted to pay that electric bill with insufficient fund checks.[50]

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[47] Daugherty Surrebuttal, Exh. 8, p. 13, lines 15-23.
[48] Tr. 254, lines 21-25.
[49] Bolin Supplemental Direct, Exh. 6, p. 5, lines 1-8 and Schedule 11; see also Merciel Rebuttal, Exh. 10, p. 8, line 20 – p. 9, line 3.
[50] Tr. 252, lines 12-18.

But the biggest unpaid obligation is the amount the Company owes for real estate taxes. Mr. Smith acknowledged that there are "property taxes past due for real property that should be in the name of Warren County Water and Sewer although [he has] transferred some of it."[51] He testified that the amount due for real estate taxes "would be probably 20-some thousand."[52] Mr. Smith apparently seemed to think this was not so bad, though, because he "maintains" that five years past due taxes is "the limit you can go."[53]

Transfer of Assets; Commingling of Funds

In addition to failing to pay its taxes and bills in timely fashion, the Company has demonstrated poor management practice by failing to provide adequate documentation for its accounting entries, by transferring utility assets to a nonregulated company and by commingling assets.

On June 28, 2001, the Company applied for a rate increase pursuant to the Commission's small company rate increase procedure, as provided in 4 CSR 240-2.200. In accordance with this procedure, the Staff conducted an investigation of the Company's request. The Staff closed that case with a letter to the Company, dated March 8, 2002, which is attached to Ms. Bolin's surrebuttal testimony, Exh. 7, as Sch. KKB-19.

The Staff there detailed many problems with the Company's accounting methods. The Staff found that the Company's records were commingled with the records of an affiliated construction company, Gary Smith and Associates, LTD, which eliminated the clear audit trail that was needed, and a lack of adequate documentation to support checks written by the

[51] Tr. 255, lines 13-17.
[52] Tr. 227, line 23 – Tr. 228, line 3.
[53] Tr. 255, lines18-21.

Company.[54] This caused "some difficulties in trying to identify actual paid invoices, just simply trying to identify what is actual operating revenues and expenses," according to Staff witness William A. Meyer, Jr.[55] One example of these difficulties is the fact that the Company issued checks totaling $74,433.27 to Mr. Smith during a 6 ½ month period in 2001 without suitable documentation, even though Mr. Smith testified that he had only received about $9,000 from the Company last year.[56]

Another example of the Company's questionable management practices is the transfer of real estate and assets, which should be owned by the company, to affiliated corporations that are not authorized to own and operate public utilities.[57] Mr. Smith has acknowledged that these assets should be owned by the Company – see footnote 51, supra. In fact, he also testified that "to satisfy everybody here," it would be best to just go ahead and transfer the real estate back to Warren County Water and Sewer and record the deed, and that he would notify the Commission when he has done so.[58]

Mr. Smith also attempted to tinker with the corporate structure of the Company, without bothering to seek the approval of the Commission. He testified that he attempted to merge Smith & Associates with the Company.[59] This is contrary to Missouri law. Section 393.190 provides that: "No … water corporation or sewer corporation shall hereafter … 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."

[54] Bolin Surrebuttal, Exh. 7, Sch. 19.2.
[55] Tr. 207, line24 – Tr. 208, line 6.
[56] Eaves Cross-Surrebuttal, Exh. 14, p. 4, lines 10-16 (adopted by Mr. Meyer at the evidentiary hearing).
[57] Merciel Rebuttal, Exh. 10, p. 9, lines 4-7.
[58] Tr. 193, lines 4-17.
[59] Smith Rebuttal, Exh. 15, p. 9, lines 11-14.

The Company's Customer Relations

OPC witness Meisenheimer testified that OPC has received complaints that the Company has estimated water usage as a surrogate for reading meters in billing.[60] Staff witness Merciel offered similar testimony.[61] Mr. Smith disputes these claims, insisting that "only 2-5% of the active meters are not read in an average month."[62]

There was extensive evidence, though, that the customers of the Company are dissatisfied with the service that they receive. The public hearing at Incline Village on March 11, 2002, was a non-stop parade of dissatisfied customers: 28 people testified at that hearing, and every one of them had a complaint about the Company's service.[63]

Mr. Merciel listed the types of complaints the Staff has received in recent years. These include: water mains that have frozen, resulting in outages; improper charges for "water service connections"; problems with the installation and maintenance of sewer pump units; inadequate sewage treatment plant operation; improper repair of streets after construction projects; and general dissatisfaction with utility service.[64] Ms. Bolin also provided a list of 11 types of complaints that OPC has received from customers of the Company.[65] These complaints have continued since the conclusion of the public hearing on March 11, 2002.[66]

It is difficult in a proceeding of this sort to determine whether the customers' complaints have merit or not. It is, however, certain that good management practice dictates that the Company give serious consideration to each of the complaints that it receives. The Company has fallen short in this regard. Mr. Smith has generally dismissed all of these complaints. He said

[60] Meisenheimer Supplemental Direct, Exh. 3, p. 8, lines 13-15.
[61] Merciel Rebuttal, Exh. 10, p. 6, lines 16-20.
[62] Smith Surrebuttal, Exh. 16, p. 2, lines 1-13.
[63] See Transcript, volume 2.
[64] Merciel Rebuttal, Exh. 10, p. 6, line 16 – p. 7, line 16.

"the same people re-hash the same complaints at every opportunity,"[67] and he described other complaints as "ridiculous," "the silliest of all complaints," and "border[ing] on the absurd."[68] He also said that legitimate complaints about chlorine should not exist,[69] that complaints are "exaggerated,"[70] and that the Incline Village Trustees "orchestrate complaints" and "the Staff simply continues to regurgitate them when the opportunity arises."[71]

Mr. Smith's hostile attitude toward complaints unfortunately manifests itself in discourteous treatment of his customers. Mr. Merciel noted that Mr. Smith has cursed customers who called to complain.[72] Staff witness Loethen has observed similar behavior,[73] and he also noted that when Mr. Smith does respond to calls from customers, he fails to give them a report on what he found or whether the problem has been repaired.[74]

Issue No. 4: Should the Commission seek the appointment of a receiver for the Company, pursuant to Section 393.145, RSMo 2000?

The Appointment of a Receiver and, Ultimately, the Sale of the Company is Essential

The Commission has the authority, in this case, to seek the appointment of a receiver for the Company. Section 393.145.1 provides, in part, as follows:

> 1. If the commission shall determine that any sewer or water corporation having one thousand or fewer customers is unable or unwilling to provide safe and adequate service … the commission *may* petition the circuit court for an order attaching the assets of the utility and placing the utility under the control and responsibility of a receiver. (Emphasis added).

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[65] Bolin Direct, Exh. 5, p. 5, lines 1-18; see also Bolin Surrebuttal, Exh. 7, p 1, line 9 – p. 2, line 15.
[66] Bolin Surrebuttal, Exh. 7, p. 9, lines 10-16.
[67] Smith Rebuttal, Exh. 15, p. 7, lines 10-13.
[68] Smith Rebuttal, Exh. 15, p. 13, lines 4-17.
[69] Smith Rebuttal, Exh. 15, p. 22, lines 5-7.
[70] Smith Rebuttal, Exh. 15, p. 23, lines 18-19.
[71] Smith Surrebuttal, Exh. 16, p. 3, lines 11-15.
[72] Merciel Rebuttal, Exh. 10, p. 7, lines 13-16.
[73] Loethen Rebuttal, Exh. 12, p. 12, lines 14-18.
[74] Loethen Surrebuttal, Exh. 13, p. 6, lines 7-20.

It is important to note that the provisions of this statute are permissive, not mandatory. The statute authorizes the Commission to seek the appointment of a receiver for a water or sewer corporation if two conditions are met: first, the corporation must have one thousand or fewer customers; and second, the Commission must find that the corporation is "unable or unwilling to provide safe and adequate service."

In this case, it is undisputed that the corporation has one thousand or fewer customers, so the first condition is satisfied. And from the discussion on the foregoing pages, it is also clear that the Company is unable or unwilling to provide safe and adequate service.

As discussed under Issue No. 1, above, Mr. Smith himself has acknowledged that there is now and has for several years been a need for additional water storage capacity. No witness testified that additional storage is not required. There is no reason to believe that this situation will change at any time in the near future. It is therefore obvious that the existing storage tank does not provide adequate service, and yet the Company has neglected to take the necessary action to correct this problem, either because it is unable or unwilling to do so.

As discussed under Issue No. 2, above, Mr. Smith has acknowledged in a plea agreement that he knowingly discharged untreated sewage to the waters of the United States, in violation of the Clean Water Act. There is credible evidence that he again violated the same provision of the Clean Water Act early this year, and there is no reason to believe that the Company has stopped such violations or that it is able or willing to provide safe and adequate sewer service to its customers.

As discussed under Issue No. 3, above, the Company has failed to discharge its obligations to pay Commission assessments, to timely file Annual Registration Reports with the Commission, to maintain its corporate charter, to pay its real estate taxes, or to collect the

primacy fees that it collected from its customers. In addition, it has transferred its assets to nonregulated affiliates without the permission of the Commission, as required by law, it has commingled assets and failed to keep adequate financial records, and its relationships with its customers are, in a word, disastrous.

It is therefore clear that the Company is unable or unwilling to provide safe and adequate service to its customers, and that the Commission has the authority, under Section 393.145.1, to seek the appointment of a receiver. The question, then, is whether the Commission should exercise this authority.

The Company's Defenses

The Company offers numerous explanations for its inability or unwillingness to provide safe and adequate service to its customers. Each of these explanations amounts to a claim that "it's somebody else's fault." They include the following:

> The opposition of the trustees of Incline Village to the Company's plan to construct a new storage tank caused the Company to incur so much legal expense that it became impractical to construct the needed storage tank;
>
> The Staff has unreasonably refused to support the Company's requests for approval of rate increases through the small company rate increase procedure, thereby making it impossible for the Company to recover its cost of service;
>
> The trustees orchestrate complaints against the Company, and the Staff regurgitates them; The Staff has refused to provide needed assistance to the Company;
>
> Customers' complaints are ridiculous, absurd, and exaggerated.

The Staff submits that each of the foregoing explanations is without merit. But it is worth noting that, even if the Company's claims were true, they would not change the fact that the Company is unwilling or unable to provide safe and adequate service to its customers. Rather, they would merely provide an explanation as to *why* the Company is unwilling or unable

to serve its customers. Furthermore, they provide no reason for the Commission to conclude that the Company will in the future be willing and able to provide safe and adequate service.

The Company's Proposal is Not Likely to Succeed

The Company opposes OPC's request for the appointment of a receiver for the Company. Although Mr. Smith testified that he does now wish to sell the Company, he naturally wants to do it on terms that are favorable, or at least satisfactory, and he believes that the appointment of a receiver will prevent him from achieving that goal.

Mr. Smith's alternative proposal involves a number of elements. They include: getting a management arrangement in position, so he can go forward with the water tower financing on behalf of the management company, and that he file for financing authority and rate authority immediately and then effectuate a sale;[75] and starting immediate with the construction of a water tower, "because all the engineering's done."[76]

But he also testified that he does not want to take personal income to subsidize the operating costs of the Company. Then, if the Company's revenues were sufficient to cover the operating costs, he would be in a position to make payments on the tank loan out of his personal assets.[77] He also said that the Company's rates need to be adjusted to a reasonable level, on an expedited basis, probably through a formal rate case and most likely emergency relief.[78]

In fact, Mr. Smith has not made a commitment for any specific course of action. It is hard to know exactly what he plans to do, and even if that were known, it would not be wise to rely upon his promises. If the Company refuses to undertake construction of the tank until it gets a rate increase, the customers of the Company may have to wait a long time for safe and

[75] Tr. 287, lines 13-18.
[76] Tr. 296, lines 5-13.
[77] Tr. 349, lines 2-13.

adequate service, because the Staff determined, in the Company's last small company rate increase proceeding that the Company is overearning even now.

Furthermore, Mr. Smith testified that he wants to spend half of his time in Texas with his wife and her child and only half of his time in Missouri. To that end, he is liquidating his assets as expeditiously as possible, and he wants to get out of the business of providing water and sewer service. Under these circumstances, it is not reasonable to believe that Mr. Smith will have the patience to pursue a formal rate case and the construction and financing of the water tower.

The Commission should reject Mr. Smith's plan.

<u>Issue No. 5:</u> If the Commission seeks appointment of a receiver, should the Commission also seek a determination, pursuant to Sec. 393.145, 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?

When a company files an application with the Commission for a certificate of convenience and necessity to provide water or sewer service to an area within the Commission's jurisdiction, the Commission requires the applicant to satisfy five conditions, which are generally known as the "*Tartan Energy* criteria."[79] Those criteria are: (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.

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[78] Tr. 354, lines 18-23.

[79] The five criteria are set forth in *In the Matter of the Application of Tartan Energy Company,* 3 Mo. P.S.C. 3d 173, 177 (1994).

The *Tartan Energy* criteria do not apply in this case, of course, because this is not an *application* for a certificate. The Staff submits, however, that if this were an application case, the Commission would find that the Company fails to satisfy at least two of these criteria. It seems clear that the Company is not qualified to provide service to Incline Village, and the Company does not have the financial ability to provide service to Incline Village.

Nonetheless, the Staff does not recommend cancellation of the Company's certificate, because this would not be in the best interest of the customers of the Company. Cancellation would leave the customers without legitimate utility service, or perhaps without any service at all.[80]

The Commission should, instead, enter an order that will allow the customers to continue to receive service, on a temporary basis, while searching for a long-term solution to the problem. For reasons that are obvious from the foregoing discussion, the Company should not continue to provide service to its customers any longer than necessary. As Mr. Merciel testified, the permanent solution to the present problem is "alternative ownership."[81]

Alternative ownership cannot be found overnight, however. The evidence indicates that there are parties who might be interested in purchasing the Company's system, at the right price. Any prudent buyer (which is the only kind the Commission would desire) would require some time to carefully evaluate the Company and the needs of its customers. The evidence does not suggest that such a buyer could be found immediately.

The best solution is, therefore, for the Commission to seek the appointment of a receiver to operate the Company, *on an interim basis*, until a buyer can be found. It is important to remember, though, that this is only an interim solution, and that the ultimate goal is to find

[80] Merciel Rebuttal, Exh. 10, p. 11, lines 6-13.
[81] Merciel Rebuttal, Exh. 10, p. 12, lines 1-3.

alternative ownership. As Mr. Merciel noted, a receiver could solve some problems, such as day-to-day financial management, but would not be in a good position to resolve the issues that require substantial capital investment, such as the construction of the additional water storage that the Company needs.[82]

The Staff believes that it is not in the best interests of the customers of the Company to return control of the Company to the owners. Nonetheless, the Commission should not ask the circuit court to make this determination, for if the court did make such a determination, the court would be obliged, under Section 393.145.5, to order the receiver to liquidate the assets of the utility. That would clearly not be in the best interests of the customers, which should be the Commission's paramount concern in this case, because it would effectively eliminate any water or sewer service in Incline Village.

The long-term interests of the Company's customers require the appointment of a receiver, on an interim basis, and the eventual sale of the Company to a qualified, competent buyer.

CONCLUSION

Warren County Water and Sewer Company has failed to provide safe and adequate water service to its customers, primarily because it has not constructed additional water storage that is needed for the health, safety, and welfare of its customers, as all parties, including Mr. Smith, agree.

The Company has also failed to provide safe and adequate sewer service to its customers, because it has not properly operated and maintained its equipment and because it has permitted hazardous discharges of untreated sewage.

[82] Merciel Rebuttal, Exh. 10, p. 13, lines 12-17.

The management of the Company has failed to operate the Company is a reasonable and prudent manner, in that it has failed to pay creditors, it has failed to comply with government requirements, it has failed to keep adequate books of account, it has commingled the assets of the Company with other, nonregulated companies that Mr. Smith owns, and it has transferred assets and attempted to merge the Company with another company without seeking the approval of the Commission as required by law.

Because the Company has been, and remains, unable or unwilling to provide safe and adequate service to its customers, the Commission is authorized, by the terms of Section 393.145.1, to petition the circuit court for the appointment of a receiver.

It is in the best interest of the customers of the Company to seek the appointment of a receiver, on an interim basis, in order to provide safe and adequate service to the customers of the Company. The Commission's ultimate goal should be to find alternative ownership for the Company. The Commission should not take any action that would result in the liquidation of the assets of the Company.

WHEREFORE, the Staff requests that the Commission find that Warren County Water and Sewer Company is unable and unwilling to provide safe and adequate service to its customers, and that it direct the General Counsel to petition the circuit court for an order attaching the assets of the Company and placing the Company under the control and responsibility of a receiver.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or e-mailed to all counsel of record this 9th day of July 2002.

/s/ Keith R. Krueger