

## **MEMORANDUM**

TO: Missouri Public Service Commission Official Case File  
Case No. WM-2002-394 - - Quail Run Water & Land Company

FROM: Dale W. Johansen – Case Coordinator  
Water & Sewer Department  
Chuck Hyneman – Accounting Department  
Ron Bible – Financial Analysis Department  
Jim Merciel – Water & Sewer Department

**/s/ Dale W. Johansen    05/23/02**

---

Project Coordinator - - Date

**/s/ Keith R. Krueger    05/24/02**

---

General Counsel's Office - - Date

SUBJECT: Staff Recommendation for Approval of Joint Application

DATE: May 24, 2002

### **Background**

On February 26, 2002, Quail Run Water & Land Company (Quail Run or Company) and the Public Funding Corporation of the City of Ozark, Missouri (PFC) submitted a Joint Application (Application) to the Commission seeking: (1) Commission approval of the sale and transfer of the Company's stock and the assets of the Company to the PFC, and approval of the subsequent lease/purchase agreement between the PFC and the City of Ozark (City), relating to the Company's assets; and (2) Commission authorization for Quail Run to discontinue providing service as of the date of the sale and transfer of the stock and assets to the PFC, with immediate continuance of service to the Company's service area by the City without jurisdiction, supervision and control of the Commission. The Company is presently a Commission-regulated water utility, and the PFC is an entity owned and operated by the City, which is a municipality that owns and operates a municipal water utility.

On March 5, 2002, the Commission issued its Order Directing Notice regarding the Joint Application. That order directed the Commission's Data Center and Information Officer to send out their standard public notices regarding the Joint Application and also established a deadline of March 25, 2002 for interested parties to submit requests to intervene in the case. No requests to intervene in the case were submitted to the Commission.

**APPENDIX A**

### **Staff's Investigation**

As noted at the beginning of this Memorandum, Staff members from the Accounting, Financial Analysis and Water & Sewer Departments participated in the Staff's review of the subject Application. Jim Merciel of the Water & Sewer Department and Chuck Hyneman of the Accounting Department created the initial draft of this Memorandum. Dale Johansen of the Water & Sewer Department then created a second draft of the Memorandum, which was based upon the first draft, and circulated that second draft to all Staff participants, the participants' direct up-line supervisors, the Staff attorney assigned to the case and that attorney's direct supervisor for review and comment. Comments received from those reviewers were then incorporated into the second draft for the creation of this final version of the Memorandum.

The Staff's investigation of the Joint Application included the following: a review of the provisions of the Joint Application; a review of the provisions of the sale/purchase agreement between the Company and the PFC; a review of the provisions of the asset lease/purchase agreement between the PFC and the City; the submittal of data requests to the Company regarding recent system improvements; conversations with representatives of the PFC and the City regarding certain aspects of the Joint Application; and a review of applicable statutes and related court cases regarding Commission jurisdiction over municipal water utilities.

### **The Sale/Purchase Agreement**

By the terms of the contract between the Company and the PFC, the PFC proposes to acquire the stock of the Company, transfer the assets of the Company to the PFC, effectively transfer the assets to the City via an asset lease/purchase agreement and dissolve the Company. Technically, approval is probably not needed for the stock sale to the PFC. Also, it appears that even after the stock is transferred to the PFC, the Company may actually exist for some amount of time into the future and retain actual ownership of the assets. However, from a practical standpoint, the City will soon have control of the water system assets by the terms of the proposed asset lease/purchase agreement with the PFC, and will be providing water service to customers as a municipal utility not subject to the jurisdiction of the Commission. Based upon this, the Staff is of the opinion that the Company's certificate should be canceled once the lease/purchase agreement is in effect.

The proposed purchase price for the Company's stock and assets is \$335,000; however, the Company's rate base is estimated to be approximately \$55,000. This is based in part on the rate base that the Staff recognized in Case No. WR-2000-337, which was the Company's net plant in service of \$41,948 (gross plant of \$57,415 less depreciation reserve of \$15,467). Additionally, since the completion of that rate case,

the Company has invested approximately \$12,800 in additional water plant, including a new 30,000-gallon water tank (Company response to Staff Data Request No. 1). As a part of the Joint Application, the PFC and, by extension the City through the PFC, represent that the Company's existing rates will continue to be charged after the transfer is complete. Of course, a future rate increase is likely to happen eventually if capital improvements are made or other increases in operating costs are incurred. This would, however, also likely occur if the Company retained ownership of the subject water system.

The general rule related to the acquisition and sale of utility assets is that the rate base component for plant in service includes only the original cost of the property to the first owner devoting the property to public service. Any amount above original cost recorded on the books of the utility purchasing such assets would be classified as an acquisition adjustment and shown separately from the plant in service amounts. Since Quail Run intends to sell its utility assets to a non-regulated entity, the acquisition adjustment issue is not pertinent to this case. However, if the utility assets currently owned by Quail Run are in the future sold to a regulated utility and used in the provision of utility service in Missouri, the proper recording of the original cost of these assets will be an issue in that future case before the Commission. This is the reason the Staff is addressing the issue of the value of Quail Run's rate base in this case.

### **The City's Water Utility Operations**

The City has operated its municipal system for many years and, in fact, through the PFC, has previously acquired other Commission-regulated water utility systems and now operates them as a part of its municipal utility. The City also provides wholesale water service to another water utility currently regulated by the PSC. Additionally, during conversations with representatives of the PFC and the City, the Staff has learned that Quail Run's service area is included in the planning horizon for future utility services.

### **Customer Comments/Complaints**

First, the Staff notes that it has confirmed that the Company sent notice of the pending purchase of its system by the PFC, and of the lease/purchase agreement between the PFC and the City, to its customers, with that notice being consistent with Exhibit G to the Joint Application. As a result of that notice, the Staff received correspondence from one person who opposes the sale, although no reason was given for the opposition.

In addition to the above, the Staff also recently received a complaint about water pressure from one of the Company's customers who said he regularly has such problems. However, at the Staff's request, the Company adjusted its pump control

settings such that the pressure does not now decrease as much, though this does result in more frequent start-stop cycling of the Company's pumps. Subsequent to those adjustments being made, the customer reported that the pressure is noticeably improved. Also, the customer noted that he had spoken with the City about this matter, and is satisfied that the City is sensitive to the problem and will handle it adequately in the future, including constructing upgrades if necessary.

### **Commission Jurisdiction**

It is clear that the Commission does not have jurisdiction over municipally-owned utilities providing service within a municipality's corporate limits. Additionally, the Commission has not historically exercised jurisdiction over municipally-owned utilities even where such utilities serve customers outside of a municipality's corporate limits, with one notable exception, which involves the City.

In Case No. WM-95-423, in which another Commission-regulated water company, namely Finley Valley Water Company, proposed to sell its assets to the PFC, the Commission approved that sale, conditioned upon the PFC submitting a tariff for Commission approval, such that its service to what will be referred to as the Finley Valley service area would remain regulated. The PFC did submit a tariff, which the Commission approved, and the PFC's service to its customers in the Finley Valley service area remains regulated to this day.

In the above-referenced case, the involved customers were extremely concerned about their relationship with the PFC and the City. Contentious issues between the PFC and the City and the Finley Valley customers included improper notice of the sale initially being sent to the customers, premature application of the City's rates under a contract operations arrangement, mis-notification to customers of Commission approval of the sale, misreading of water meters, poor communications with customers regarding questions and a non-utility related issue of an objectionable proposal to change street names and mailing addresses. These issues were aggravated by the fact that the customers are not residents of the City, and ultimately were not included in the representative process in connection with the City running its municipal utility operation. Residents, of course, are included in the process through elections of city council members. The Staff would note, however, that the water system operating issues were appropriately dealt with by the PFC and the City during the pendency of the Finley Valley case or shortly thereafter.

In its "Order Approving Sale, Order Granting Intervention, and Order Requiring Tariff" in the above-referenced case, and in other related orders issued in that case, the Commission outlined its consideration of the statutes and court interpretations regarding the matter of its jurisdiction over municipal utility service being provided beyond a

municipality's corporate limits, which the Commission then used in reaching its decision to exercise jurisdiction over the PFC's and the City's service to customers in the Finley Valley service area.

### **Staff's Conclusions**

City Operations: The Staff's conclusion regarding this matter, which is based on the City's response to the customer complaint discussed above and the Staff's experience in dealing with the City on past matters, is that the City is capable of providing good service to its customers – including those on the Company's system. As a result, it is the Staff's opinion that the proposed sale and transfer of the Company's stock and its assets to the PFC, and the subsequent lease/purchase agreement between the PFC and the City, are not detrimental to the public interest.

Jurisdiction: Although Commission jurisdiction over municipal utility service beyond municipal corporate limits may be a debatable issue, and one on which considerable time could be spent, the Staff has concluded that for the purposes of this case the Commission should adopt its historical position of not exercising jurisdiction over municipal utilities providing service beyond a municipality's corporate limits. With the exception of the Finley Valley situation, this would be a "status quo" approach, in that there are numerous municipalities in Missouri that provide water utility service beyond their corporate limits without Commission oversight. In fact, the City provides such service outside its corporate limits in areas other than the Finley Valley service area, which includes the provision of wholesale water service to another Commission-regulated water utility. Significant also is the fact that contentious issues such as those that were a part of the Finley Valley case do not exist with regard to this case.

### **Additional Information**

Pursuant to a review of available electronic information maintained by the Commission's Internal Accounting Department and Data Center, the Staff notes that the Company was current on the payment of its Commission assessments and on the filing of its Commission annual reports when it and the PFC submitted the Joint Application, and that the Company remains current on those matters as of the writing of this Memorandum. The assessment information reviewed covers FY1996 thru FY2002, and the annual report information reviewed covers CY1997 thru CY2001.

Additionally, the Staff notes that the Company currently has no other matters pending before the Commission, and that approval of the Joint Application in this case will thus not affect any other matter before the Commission with regard to the Company.

**Staff's Recommendations**

Based upon the above, the Staff recommends that the Commission issue an order in this case that:

- 1) Approves the PFC's and the Company's Joint Application and grants the authority requested therein;
- 2) Directs the PFC to notify the Commission immediately after it executes the asset lease/purchase agreement with the City; and
- 3) Cancels the Certificate of Convenience and Necessity held by the Company, and the Company's water tariff, effective upon the PFC's execution of the asset lease/purchase agreement with the City.