BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri-American Water Company for a Certificate of Convenience and Necessity Authorizing it to Install, Own, Acquire, Construct, Operate, Control, Manage and Maintain a Water System and Sewer System in and Around the City of Eureka, Missouri	)	**Case No. WA-2021-0376**

MISSOURI-AMERICAN'S REPLY BRIEF

COMES NOW Missouri-American Water Company ("MAWC," "Missouri-American" or "Company"), by and through the undersigned counsel, and states the following to the Missouri Public Service Commission ("Commission") as its *Reply Brief*.

This *Reply Brief* will address the *Initial Post-Hearing Brief* of the Office of the Public Counsel ("OPC") and the *Initial Post-Hearing* Brief of the Staff of the Commission ("Staff") as to certain matters raised by those briefs.

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INTRODUCTION

The Staff and OPC Initial Post-Hearing Briefs are interesting in that they promote an interpretation of Sections 393.170 and 393.320, RSMo that would render Section 393.320 meaningless. Their interpretations suggest that the Commission maintains all power under Section 393.170.3 to make any determination it wants, to include the appropriate ratemaking rate base, under the "necessary or convenient for the public service" standard found therein.

MAWC certainly does not take the position that 393.320 supplants Section 393.170, as alleged by Staff (Staff Ini. Brf., p. 7 ("MAWC's interpretation creates an impermissible conflict . . .")). However, it does believe that 393.320 has import, can be reconciled with Section 393.170, and cannot be completely ignored as suggested by Staff and OPC. Section 393.320.8 states, in part, as follows:

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

(emphasis added). Accordingly, Section 393.320, once chosen, is determinative as to "determining the ratemaking rate base of small water utilities" in situations such as the matter at hand. However, all other issues under Section 393.170 remain for Staff's investigation and recommendation.

In this case, the appraisal called for by Section 393.320 has been performed by highly qualified and experienced appraisers. There is no testimony from a certified appraiser that criticizes this appraisal. (Tr. 257 (Gateley)). And no other evidence of the fair market value of the water and sewer systems or review of the appraisal was provided. (*Id*. (Gateley); Exh. 4, Batis Sur., pp. 4-5). There is only criticism from witnesses that have no experience conducting

appraisals, preparing reports for appraisers or establishing the fair market value of utility systems.

The Staff witnesses primarily approach the case consistent with their background – they seek to use their idea of net book value as the center point of all discussion. Staff states that "MAWC requests Commission approval of a transaction with sales prices substantially above the time-tested regulatory valuation of those systems." (Staff Ini. Brf., p. 20). This statement is wrong for two reasons – 1) It ignores completely that MAWC is acting in accordance with Section 393.320, (a statute the Staff wants the Commission to ignore); and, 2) Municipal systems have no "time-tested regulatory valuation" of such systems. They have not been regulated by the Commission and do not account for assets or depreciate assets like a regulated system would. The General Assembly recognized this fact and Section 393.320 provides a method to address it.

Moreover, as explained in MAWC's *Initial Brief*, "fair market value" and "net book value" (the assumed "time-tested regulatory valuation") are two completely separate concepts[1] and there are many issues with attempting to estimate net book value for a municipal system.[2] (MAWC Ini. Brf., pp. 18-21). Section 393.320 makes clear that net book value is not relevant to unregulated systems (Section 393.320 does recognize a difference as to systems that are already regulated). This is because the accounting performed by municipal systems, water districts, sewer districts, and privately owned utilities that are not public utilities, is far different from that utilized before the Commission, which makes the determination of a "net book value," extremely

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

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

difficult, if not impossible, to determine for those entities. (Exh. 12, LaGrand Sur., p. 7). It is no surprise that net book value and fair market value could diverge in a significant fashion.

Staff attempts to create an issue as to the water system appraisal price per customer that results from the sales comparison approach. However, there is little mention of how the sewer system appraisal compares. As shown in the Eureka appraisal report, the analysis of the sewer system found average unit prices from the comparable sales were $2,920 for all of the sales and $2,782 for the group of sales after elimination of sales under 500 customers and over 9,000 customers. (Exh. 4, Batis Sur., p. 8; Exh. 3, Batis Dir., Sched JEB-2, pp. 76-77 of 98). The unit value for the Eureka sewer system concluded by the three appraisers was $2,500 per customer, which is below the averages illustrated in the two exhibits. (*Id*.).

It is also a different story when the valuation of the combined water and sewer systems is examined. The median unit price for combined system purchases is $3,100 per customer. (Exh. 3; Batis Dir., Sched. JEB-2, p. 78 of 98; Exh. 4, Batis Sur., p. 9). This included combined prices as high as $4,721; $4,100, $3,801; and, $3,784 per customer. (*Id*.). The conclusion of value for the Eureka combined systems was $3,500 per customer, which is well within the range indicated by the market data and very close to MAWC's approximate, existing per customer investment of $3,540, as of December 31, 2020.[3]

Staff further wants to modify "fair market value" based upon future intended uses. Following this suggestion would lead to an absurd result. Staff essentially argues that the fair market value of the Eureka water system should be less if purchased by MAWC, which has other facilities in the area and can bring efficiencies to its existing treatment plants, than it would be if the Eureka water system were purchased by Liberty water, which has no facilities in the area. A

[3] Total rate base as of December 31, 2020, was $1,716,864,497 (Exh. 11, LaGrand Dir., p. 9). Total water and sewer customers were approximately 485,000 (470,000 water and 15,000 sewer) (Exh. 5P, Eisenloeffel Dir., p. 5).

more common extension of this theory is that in estimating the fair market value of a used car, Kelly Blue Book should have a price for a buyer that will utilize the car in a demolition derby, and a separate fair market value for a person that intends to drive the car to work and to home. That approach is contrary to the concept of a fair market value.

Moreover, Staff's criticism of MAWC's conduct in regard to the GIS data referenced in this case is also curious. It appears that **Staff believes *that MAWC should have WITHHELD, to the possible detriment of a Missouri municipality, material information of which MAWC was aware***. Note that there is no criticism of the validity of the information itself – only a suggestion that MAWC should have kept this information to itself and not shared this information with anyone. The sort of dealing promoted by Staff would not seem to be an approach the Commission would want to encourage.

What we are left with in this case are criticisms of a fair market value utilizing an unrelated and unreliable estimated "net book value", criticisms of an appraisal process with which Staff has no expertise and no experience, and attempts to nullify a statute, Section 393.320, that Staff and OPC just don't like.

Lastly, Staff seeks to direct and manage how Eureka addresses its system. Staff coldly states as follows:

> While Eureka's drinking water may not have the best flavor, it currently meets DNR requirements *and is drinkable*. While improvements to Eureka's water and sewer utilities may be desirable or necessary, the City of Eureka can accomplish them by taking advantage of public funding sources available to municipalities. Eureka's water and sewer systems are not troubled utilities, and no emergency would be solved simply by MAWC's acquisition of these systems. Eureka residents have alternatives, if the sale to MAWC does not occur.

(Staff Ini. Brf., p. 20 (emphasis added)). In Army terms, Staff is telling Eureka to "go pound sand." Staff is in favor of any alternative, and maybe no alternative, but for the alternative

chosen by Eureka and its citizens after an extensive campaign and eventual successful vote to sell.

The Commission should grant MAWC the requested certificates of convenience and necessity ("CCN") to provide water and sewer service within the identified service area in and around the City of Eureka utilizing the Eureka systems and to and establish the ratemaking rate base for the systems acquired at amounts equal to the fair market value.

STATUTES

Statutory Interpretation

Section 393.320 is a statute adopted by the Missouri General Assembly establishing a streamlined process concerning the acquisition of smaller water or wastewater utilities by large water or wastewater public utilities. (Exh. 11, LaGrand Dir., pp. 5-6). In certain circumstances, it can be used in conjunction with either Section 393.170, where a CCN is required, or Section 393.190, when a large utility is purchasing a small, regulated utility. There seems to be some dispute as to how these statutes fit together. MAWC believes that Section 393.320 is meant to have some import, while Staff and OPC appear to believe that Section 393.320 has no import.

The following matters related to statutory interpretation were cited by the Commission in its *Order Denying Motion for Partial Summary Determination et al.*, p. 8, Case No. WA-2020-0397 (Issued July 28, 2021).

> "The provisions of a legislative act are not read in isolation but construed together, and if reasonably possible, the provisions will be harmonized with each other."[4] "In determining the intent and meaning of statutory language, the words must be considered in context and sections of the statutes in *pari materia*, as well as cognate sections, must be considered in order to arrive at the true meaning and scope of the words."[5] In ascertaining legislative intent, courts are guided by established rules of statutory construction, including the rule known as "*expressio*

[4] *Bachtel v. Miller Cty. Nursing Home Dist*., 110 S.W.3d 799, 801 (Mo. banc 2003).
[5] *State ex rel. Evans v. Brown Builders Elec. Co.,* 254 S.W.3d 31, 35 (Mo. banc 2008); cited in *R.M.A. by Appleberry v. Blue Springs R-IV School District*, 568 S.W.3d 420, 429 (Mo. banc 2019).

unius est exclusio alterius" (i.e., "the express mention of one thing implies the exclusion of another").[6]

Staff recites that "repeal by implication is disfavored.[7] If two statutes can be reconciled, both must be given effect.[8] Sections 393.320, RSMo and 393.170, RSMo can be reconciled, and both can be given effect." (Staff Ini. Brf., p. 5). Further, Staff suggests that "the Commission should find that there is no conflict between the appraisal statute and the Commission's statutory requirement to determine whether the transaction is necessary or convenient for the public service." (*Id*. at p. 6).

MAWC generally agrees with this assessment. However, Staff and OPC's approach to assessing what is "necessary or convenient for the public service" would essentially permit the Commission to choose whatever ratemaking rate base it believes appropriate without regard to Section 393.320. That approach would leave Section 393.320 with no effect.

As previously noted, language of Section 393.320, indicates that when chosen, the use of the appraisal for the purpose of setting the ratemaking rate base is mandatory, not discretionary. The statute requires, in part, as follows:

> 2. **The procedures contained in this section may be chosen by a large water public utility, and if so chosen shall be used by the public service commission** to establish the ratemaking rate base of a small water utility during an acquisition.
> *****
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> 5. (1) **The lesser of the purchase price or the appraised value, together with the reasonable and prudent transaction, closing, and transition costs incurred by the large water public utility, shall constitute the ratemaking rate base** for the small water utility as acquired by the acquiring large water public utility; provided, however, that if the small water utility is a public utility subject to chapter 386 and the small water utility completed a rate case prior to the acquisition, the public service commission may select as the ratemaking rate

[6] *McCoy v. Hershewe Law Firm, P.C.,* 366 S.W.3d 586, 593-594 (Mo. App. W.D. 2012).
[7] *St. Charles County v. Director of Revenue*, 961 S.W.2d 44, 47 (Mo.banc 1998). *See also*, *State ex rel. Coffman v. Pub. Serv. Comm'n*, 154 S.W.3d 316, 328 (Mo.App.W.D. 2004).
[8] *Id*.

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

(emphasis added).

Rather than address this prescriptive language, Staff worries that if Section 393.320 is given any import, "utilities will have a blank check to increase their rate base via the appraisal statute without any inquiry into the public interest," "that there is an impermissible conflict between [Section] 393.320, RSMo and [Section] 393.170(3), RSMo," and the Commission's "role will be reduced to being a rubber-stamper for the many applications utilities will likely file pursuant to the appraisal statute." (Staff Ini. Brf., p. 6 and 7). None of these concerns are warranted.

Initially, it should be recognized that Section 393.320 is targeted to a specific situation –a subset of water and sewer acquisitions. More importantly, the "sky is falling" assessment of Section 393.320 ignores the matters that continue to be necessary for a Commission decision – at a minimum, a need for the service; an applicant qualified to provide the proposed service; an applicant with the financial ability to provide the service; a proposal that is economically feasible; a resulting decision as to the public interest; and an appraisal agreed to by three appraisers that are certified under the laws of the State of Missouri.

The Commission can easily reconcile Sections 393.170 and 393.320 by both examining the question of "necessary or convenient for the public service," and giving Section 393.320 its due in regard to its impact on the setting of ratemaking rate base. These concepts are not

contradictory and provide a measured way to encourage the acquisition of small water and sewer systems by large systems.

Necessary and Convenient for the Public Service (Tartan Factors)

The Commission articulated criteria to be used when evaluating applications for utility certificates of convenience and necessity in the case *In Re Intercon Gas, Inc., 30 Mo P.S.C. (N.S.) 554, 561 (1991)*. The *Intercon* case set forth the following criteria, commonly known as the "*Tartan Factors*" or the "*Tartan* Energy Criteria"[9]:

(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.

MAWC believes that these factors remain relevant and should be considered by the Commission.

The Staff's *Initial Post-Hearing Brief* stated that it "agrees that MAWC satisfies the first four Tartan factors, but not the fifth. . . ." (Staff, Ini. Brf., p. 3). That leaves the question whether the proposed service – in this case water and sewer service to Eureka – will promote the public interest.

The Commission has indicated that positive findings with respect to the first four standards above will in most instances support a finding that an application for a CCN will

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

promote the public interest.[10] Thus, under the Commission's previous interpretation of "necessary and convenient for the public service," the public interest question is satisfied.

Beyond that historic Commission approach, MAWC detailed in its *Initial Brief* a number of other factors that support a finding that the issuance of the requested CCNs is in the public interest. (MAWC Ini. Brf., pp. 9-11). These factors included benefits for the Eureka systems and customers, benefits for Eureka and its citizens, and benefits for MAWC's existing customers. (*Id*.).

Staff specifically argues that "using the appraised value of $28 million as the basis for rate base is contrary to the public interest." (Staff, Ini. Brf., p. 3). Its definition of public interest must necessarily ignore the expression of the public interest provided by the General Assembly in Section 393.320. Use of the "appraised value" or, as it is referred to by Section 393.320, the "fair market value," is consistent with the public interest as reflected in the statutes of the State of Missouri.[11]

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

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

[11] *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc.*, Report and Order, Case No. EM-2007-0374, 2008 Mo. PSC LEXIS 693, 458-459 (MoPSC July 1, 2008) ("The public interest is found in the positive, well-defined expression of the settled will of the people of the state or nation, as an organized body politic, which expression must be looked for and found in the Constitution, statutes, or judicial decisions of the state or nation, and not in the varying personal opinions and whims of judges or courts, charged with the interpretation and declaration of the established law, as to what they themselves believe to be the demands or interests of the public.") (emphasis added).

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APPRAISAL

Staff alleges that the requested CCNs are "not necessary or convenient for the public service, because the appraisers did not follow the process to produce a sufficient, neutral appraisal." (Staff Ini. Brf., p. 10). This is an incredible statement considering that Staff provided no testimony from certified appraisers and no Staff witness is qualified to perform an appraisal review.

As detailed in MAWC's *Initial Brief* (MAWC Ini. Brf., pp. 13-15), the appraisers have extensive experience in the valuation of water and wastewater utility systems (Exh. 3, Batis Dir., p. 7); are individually and collectively well-qualified, experienced in all types of valuation assignments, and have extensive training in Uniform Standards of Professional Appraisal Practice ("USPAP") (Exh. 4, Batis Sur., p. 6); and have provided appraisal and/or valuation consulting services for buyers and sellers in multiple states and for valuation assignments that required similar state regulatory requirements (Exh. 3, Batis Dir., p. 7).

Moreover, Mr. Batis has literally "taught the course" on appraisal of water and wastewater systems as he has developed and presents a seminar for professional real estate appraisers on the fundamentals and methodology for appraising water and wastewater utility systems. (Exh. 4, Batis Sur., p. 6). The methodology employed for the Eureka appraisal is consistent with the seminar material that Mr. Batis developed and presented for professional appraisers in the State of Missouri. (*Id*.) The seminar was approved by Missouri for continuing education hours for professional, state-certified real estate appraisers. (*Id*.).

Additionally, Mr. Batis stays on top of the market for water and sewer properties. He makes it a habit to reach out to clients several times a year to ask about both projects he participated in and some he has not, to gather closing information. (Tr. 165 (Batis)). He also has

a researcher that reviews dockets and performs Internet searches to gather that type of information. (*Id*. at pp. 165-166 (Batis)).

Given the substantial experience and expertise of the appraisers in this matter, the Commission should carefully consider the weight that is appropriate for Staff's various concerns, since it is admittedly taking its first opportunity to "substantially consider" the "parameters" of appraisals under Section 393.320. (Staff Ini. Brf., p. 1).

Further, because this is Staff's first substantial consideration of the appraisal parameters, MAWC wonders why during the approximately 158 days between the filing of the application in this case (April 26, 2021) and the filing of the Staff Recommendation Staff never asked to discuss their questions with the appraisers themselves or provide their own certified appraiser to review the appraisal? Perhaps that is because the very use of Section 393.320 is its real issue, not the sufficiency of the appraisal.

Sales Comparisons

The Staff criticizes the appraisers' use of the sales comparison approach based on Staff's observations of the water system examples found in the Valuation Report. (Staff Ini. Brf., pp. 16-17). Because the per customer value used by the appraisers for the water system exceeded those selected examples, Staff alleged that the appraisal was "insufficient." (*Id.*).

For background, the sales comparison approach is one of the three traditional valuation approaches utilized by professional, state-certified, real estate appraisers. (Exh. 4, Batis Sur., p. 7). It is an approach to value that relies on the principle of substitution as stated and defined on Page 46 of the Eureka appraisal report. (*Id.*; Exh. 3, Batis Dir., p. 51 of 98).

To state that an appraisal opinion is incorrect or flawed because it exceeds the prices of the comparable is not only inappropriate, but inconsistent with the fundamental rules of the

appraiser profession, namely USPAP, that requires the opinion of value be developed objectively and without bias or based on pre-determined conclusions – such as a limitation or restriction on the value conclusion. (Exh. 4, Batis Sur., p. 7). It also ignores the fact that the appraisers have already weeded out sales before preparing the Valuation Report. In this case, the appraisers were aware of transactions that took place at or above the $4,500 per customer amount, to include some as high as $10,000 per customer level. (Tr. 158 (Batis)). Examples of some of those are seen in the Direct Testimony of MAWC witness Batis. (Exh. 3, Batis Dir., Sched. JEB-3, p. 1, 5, 6, 8 of 9). Thus, while it is true the water system appraisal, on a per customer basis, exceeded the examples in the Valuation Report, it would very much be incorrect to state that the appraised value exceeded the known transactions.

The fact that the appraisers independently viewed the information without a biased approach to the fair market value can be seen by looking no further than the sewer assets. As shown in the Eureka appraisal report, the analysis of the sewer system found average unit prices from the comparable sales were $2,920 for all of the sales and $2,782 for the group of sales after elimination of sales under 500 customers and over 9,000 customers. (Exh. 4, Batis Sur., p. 8; Exh. 3, Batis Dir., Sched. JEB-2, pp. 76-77 of 98). The unit value for the subject property concluded by the three appraisers was $2,500 per customer, which is below the averages illustrated in the two exhibits. (*Id.*).

A balanced view of the systems is also seen in regard to the data related to the combined water and sewer systems sales comparison. This information is found in the Eureka appraisal report and includes additional analysis and explanation regarding the valuation of the water and wastewater systems combined. (Exh. 3; Batis Dir., Sched. JEB-2, p. 78 of 98; Exh. 4, Batis Sur., p. 9). The average unit price is found to be $2,890 per customer and the median unit price $3,100

per customer. (*Id*.). This included combined prices as high as $4,721; $4,100, $3,801; and, $3,784 per customer. (Exh. 3; Batis Dir., Sched. JEB-2, p. 78 of 98). The conclusion of value for the Eureka system, based on the combined systems was $3,500 per customer, which is well within the range indicated by the market data, and considered by the certified appraisers to be reasonable and supported.

For the conclusion of value for both the water and sewer systems, the analysis of the market data takes into account the locations of the properties, the market conditions which prevailed when the comparable properties were sold, and the physical components of the properties. (Exh. 4, Batis Sur., p. 8). With respect to the physical components, attributes are weighed based upon the degree of similarity observed between a comparable sale and the subject property. (*Id*.). The analysis takes into account the number of connections, the length of mains, and the type of treatment facilities. (*Id*.). Also given weight is the condition of the improvements, the age of the improvements, and the level of capital improvements that were made in the years prior to the acquisition. (*Id*. at pp. 8-9). For purposes of analyzing the physical condition of system components, emphasis is placed on condition/assessment reports (as available by the system operators or communities in which they are located and by whom they are owned), engineering reports and inventory lists, and other reports and documents as available. (*Id*. at p. 9). Bracketing of market data by size of the system (and the number of connections) also is also considered in determining the appropriate unit values applicable to the subject property systems. (*Id*.).

Future Use Not Appropriate for Consideration

OPC and Staff suggest that the "future use" of the systems should be considered in regard to either the fair market value or to whether the transaction is "necessary or convenient for the

public service." (OPC Ini. Brf., p. 9; Staff Ini. Brf., p. 14 (". . . future use is relevant and should have been considered. . .")). The argument is that there is a deficiency in the appraisal because it does not consider that the future use of the wells is intended to be something different after a MAWC purchase. (Staff Ini. Brf., p. 11). This is a water system issue only and MAWC will discuss the specific implications of its plans as to the wells and associated equipment in the "Wells and Water Treatment Equipment" section of this Brief.

First, as noted in the introduction, there is no testimony from a certified appraiser that criticizes the appraisal presented in this case. (Tr. 257 (Gateley)). And no other evidence of the fair market value of the water and sewer systems or review of the appraisal was provided. (*Id*. (Gateley); Exh. 4, Batis Sur., pp.4-5).

More importantly, the Valuation Report provides an opinion of value for the subject property system/assets "as is" as of March 18, 2020 and is not based upon future or speculative changes, additions, modifications, etc. (Exh. 3, Batis Dir., p. 10). It is improper and misleading for an appraiser to assume, for valuation purposes, the occurrence of some act, event, or change in the future when developing a market value opinion for a property "as is" (as it actually is known to exist) as of the effective date of value. (*Id*. at p. 11; Exh. 4, Batis Sur., pp. 6-7).

The basic problem with Staff's position is that it ignores that the appraisal is to determine "fair market value." Appraisals can be prepared "as is" or based upon a number of extraordinary assumptions and hypothetical conditions. (Exh. 4, Batis Sur., p. 10). The subject appraisal was developed based upon the system "as is" as of the effective date of value. (*Id*.) The referenced wells were in service and being used at the time the Valuation Report was prepared. (Exh. 3, Batis Dir., p. 11). Thus, they must be considered in the determination of <u>fair market value</u>.

Using the analogy of Staff witness Mr. Gateley and the purchasing of a used vehicle (Exh. 101, Gateley Reb., p. 6), the Commission should consider the following question posed by Mr. Batis:

> If the vehicle has a certain value (say, $10,000), but the buyer intends on using the vehicle for parts and scrapping the vehicle, should the seller accept less money? Of course not. The [fair market value] of the car is $10,000 regardless of what the buyer will do after the acquisition.

(Exh. 4, Batis Sur., p. 10). The same principle holds for the valuation of the subject property. (*Id*.). Staff's position contradicts the most basic and fundamental valuation principles. (*Id*.).

Impacts of Issues on Appraisal

Staff suggests that by not reviewing DNR information in the Flinn Report, the Report did not consider "information that influences the appraised value." (Staff Ini. Brf., pp. 15-16). Of course, the appraised value is a question for the appraisers, not Ms. Simpson and her report, which does not attempt to derive a fair market value (something she is not licensed to do). (Tr. 243 (Simpson)).

However, Mr. Batis did testify that this is not the sort of information for which he would normally adjust a fair market value. (Tr. 164 (Batis)). He stated:

> That type of information is not something that is factored into our equations or our analysis, our qualitative analysis because we know those situations exist with, you know, the majority of the data. And with most of the property that we've appraised we even have indication or records or proof or evidence that there might have been DNR issues or environmental issues.
>
> That's normally the case of why these systems are being acquired, because they've gotten to a point where they're not brand new operating at 100 percent state of the art efficiency. It goes with the territory and we see that in most if not all the systems.

(*Id*.).

The significance, or lack thereof, of the DNR information is discussed in the "DNR Compliance Issues (Concerns Sewer System Only)" section below.

No "Inflated" Price

Both OPC and Staff suggest that the appraisal has resulted in an "inflated" price. (OPC Ini. Brf., p. 9; Staff Ini. Brf., p. 7 and 8).

The first question is "inflated over what?" As mentioned previously, there is no other evidence in this case of the fair market value of the Eureka water and sewer systems. Net book value is not the same as fair market value and, as to a municipal system, there is no mention of net book value in Section 393.320. Thus, a comparison of fair market value to net book value cannot indicate an "inflated price." The whole purpose of having certified appraisers provide an opinion as to fair market value is to bring third-party analysis into the purchase process. Staff's assault on the work of the certified appraisers is contrary to the very concept of the appraisal process.

More significantly, as mentioned above, the combined water and sewer system price of $3,500 per customer is well within the range indicated by the market data. (Exh. 3; Batis Dir., Sched. JEB-2, p. 78 of 98; Exh. 4, Batis Sur., p. 9). This analysis included combined prices as high as $4,721; $4,100, $3,801; and, $3,784 per customer. (Exh. 3; Batis Dir., Sched. JEB-2, p. 78 of 98). This combined price is also very close to MAWC's approximate, existing per customer investment of $3,540, as of December 31, 2020.[12] The fair market value, as found by the appraisal, is not "inflated" and fairly represents the market for these combined transactions.

[12] Total rate base as of December 31, 2020, was $1,716,864,497 (Exh. 11, LaGrand Dir., p. 9). Total water and sewer customers were approximately 485,000 (470,000 water and 15,000 sewer) (Exh. 5P, Eisenloeffel Dir., p. 5).

FLINN REPORT

Prior to addressing what Staff views as deficiencies in the Flinn Report, it is helpful to remember how that report fits into the appraisal process. First, it is not a statutory requirement. Mr. Batis stated that it was a statutory requirement in most states with which he is familiar (Tr. 169-170 (Batis)). However, Missouri and Section 393.320 do not require that report. Thus, the Flinn Report was performed at the request of the appraisers and its purpose and impacts on the ultimate appraisal are subject to the judgment of the certified appraisers. The Flinn Report does not purport to be an appraisal and Ms. Simpson does not claim to be a certified appraiser.

Ms. Simpson finds that every report she does for appraisers is based on limited information. (Tr. 209 (Simpson)). For example, she would loved to have had documentation of the cost of the assets and the years in which they were installed available on a comprehensive spreadsheet. (*Id*.). However, she has never received that information. (Tr. 242 (Simpson)).

Staff, on the other hand, makes allegations as to what it believes *should have been done* in the Flinn Report and the impact issues *should have had* on the appraisal. It does this without any representation that either of the Staff witnesses have prepared an appraisal, are certified appraisers, or have prepared or submitted a report in support of an appraisal. On the other hand, the appraisers that did prepare the Valuation Report are certified and have extensive experience performing appraisals of water and sewer systems. Ms. Simpson is experienced in providing reports for the use of appraisers in these circumstances.

The appraisal has been conducted "in accordance with Missouri law and with the Uniform Standards of Professional Appraisal Practice." (Section 393.320.3(2)(a)). The Valuation Report was prepared in conformance with Standards Rule 2-2(a) of the 2020-2021 Edition of the Uniform Standards of Professional Appraisal Practice ("USPAP"). (Exh. 3, Batis Dir., p. 6). In

addition to being prepared in compliance with USPAP, the Valuation Report was prepared in accordance with the Code of Ethics and Standards of Professional Practice of the Appraisal Institute. (*Id*.)

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

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

Site Visit

Staff takes issue with the fact that Ms. Simpson's report was prepared without having viewed in person the above-ground assets of Eureka's water and sewer systems. (Staff Ini. Brf., p. 14-15). Staff indicates that this "methodology of preparing reports runs counter to Staff's experience." (*Id*.). Of course, Staff's "experience" does not include preparing a report for appraisers.

Ms. Simpson's assignment was to provide a high-level review of the condition of the systems,[13] estimate the 2019 installation cost, and estimate the depreciated book value of the

[13] In other situations, Ms. Simpson does do other types of reviews, which she would call a "due diligence report." (Tr. 227 (Simpson)). That would be a much, much bigger level of effort in that it would include digging into records, looking at maintenance records, leak records, and anything else that would give her a sense of the condition

assets, based on the 2019 estimated installation cost and the estimated age of the assets. (Exh. 9, Simpson Dir., pp. 4-5; Tr. 203-204 (Simpson)).

Unlike Staff, Ms. Simpson does have experience providing this type of report for appraisers in that it is an assignment she has performed many times in the past. (Tr. 224 (Simpson)). Since 2017, Ms. Simpson has worked on 24 similar reports for appraisers (21 completed and 3 ongoing). (*Id*.). She would describe every one of those reports to call for a "high-level review" such as that performed for Eureka. (Tr. 225 (Simpson)).

Here, Ms. Simpson was able to perform the task assigned by the appraisers by reviewing photographs of the above-ground assets, as was noted on the first page of the report that "[t]he high-level review of the condition of the system is based on the data provided by the City and photos that were taken by others during a site visit. Flinn Engineering did not visit the site." (Exh. 9, Simpson Dir., p. 5).[14] While Ms. Simpson would ideally visit the site, it is not necessary for purposes of the high-level review. (Tr. 205 (Simpson)). In fact, the Eureka matter was not the first time Ms. Simpson has prepared a report for appraisers in this fashion. (Tr. 241 (Simpson)).

Of course, the ultimate question is not what Staff, in its inexperience, thinks of this process. The question is whether the appraisers found it sufficient, given their significant experience. In this case, they did. (Exh. 3, Batis Dir., p. 11-14).

As a confirmation, Ms. Simpson did subsequently visit Eureka to view the mechanical conditions of the above-ground assets in person. (Exh. 10, Simpson Sur., p. 3). This included

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of assets and make recommendations for improvements. (*Id*.). MAWC performed the due diligence review itself as to Eureka. (Tr. 244 (Simpson)).

[14] Ms. Simpson did initially have the opportunity to sit down in person with Eureka personnel in August of 2019. (Tr. 222-223 (Simpson)). Through that process she was able to ask typical questions of Eureka personnel and receive answers in person. (*Id*. at 223 (Simpson)).

wastewater treatment plant, to include the influent pump station building, the 3-cell lagoon, the blower building, and the UV system. (*Id*. at pp. 3-4). She also viewed the Arbors well, treatment, tank, and booster; Niehoff/Augustine tank and booster; Howerton Road well and treatment; Viola well, treatment, tanks, and boosters; Cahoon lift station; Kircher (Stonebridge) lift station; and, Truitt (Raineri) lift station. (*Id*. at p. 4).

At the wastewater treatment plant, Ms. Simpson observed the condition of the screen in the influent pump station building, the berms around the lagoons, the diffuser piping that was visible in the lagoons, the Aquamats® that were visible in the lagoons, the equipment in the blower building, the generator, and the UV equipment (which only operates seasonally as needed (typically April to October). (Exh. 10, Simpson Sur., p. 4).

The assets appeared to be in working order and in good condition. (Exh. 10, Simpson Sur., p. 4). The generators at the various sites are fully or nearly fully depreciated but appear to be in good to very good condition. (*Id*.) Newer assets at the Niehoff tank and booster and the Arbors well, treatment, tank, and booster also appeared to be in very good condition. (*Id*.). The Viola storage tanks and pumps are fully depreciated, still in operation and appear to be in good condition.[15] (*Id*. at p. 5). The softening equipment at the Viola site appears to be in very good condition. (*Id*.). Older assets such as the Cahoon lift station and Stonebridge lift station, which are fully depreciated, but still in operation, appeared to be in poor to fair condition due to their age. (*Id*.).

Ms. Simpson did not see anything that would change her previous "high level" opinion of the assets as being in "good" (or "C" - average) condition. (Exh. 10, Simpson Sur., p. 4, 5; Tr. 205, 206, 241-242 (Simpson)). This issue has n impact on the ultimate fair market value found in the Valuation Report.

[15] Although Staff's net book value would assign zero dollars to these assets. (Tr. 279-280 (McMellen)).

Photographs

It should also be noted that Staff's *Initial Post-Hearing Brief* referred to the photographs reviewed by Ms. Simpson and provided to the Commission as Exhibit 301 to be "Undated photographs". (Staff Ini. Brf., p. 14, FN 42). While the versions that the data center entered into EFIS were converted into pdf format (presumably what was necessary to add the photographs to EFIS), that is NOT the format in which they were supplied to the Commission (which was JPG). The photographs in JPG format (as opposed to the maps, as was referenced in MAWC's cover pleading) contain "Date Taken" information. After discussion of this issue with the parties and the RLJ, the data center has renamed the files to reflect the date taken (December 10, 2019).

DNR Compliance Issues (Concerns Sewer System Only)

It should be remembered that Staff's statements in regard to Missouri Department of Natural Resources ("DNR") matters concern only the Eureka sewer system and not the water system, which Staff indicates is in fair to good condition (Exh. 101, Gateley Reb., Sched. CBG-r2, p. 10; Tr. 258 (Gateley)). Staff further found the water system general housekeeping, grounds maintenance and site security to be very good. (*Id*.).

Staff incorrectly suggests that "it does not appear that anyone involved in this case, except Staff, requested and reviewed the Eureka systems' DNR records." (Staff Ini. Brf., p. 11). MAWC witness Eisenloeffel indicates clearly that:

> The referenced MDNR inspection reports and Letters of Warning were obtained by Missouri American Water Company (MAWC) through the same process used by Staff, in <u>in a formal request May 13, 2020</u>. This is a standard part of our due diligence process on all potential acquisitions by MAWC.

(Exh. 6, Eisenloeffel Sur., p. 3).

Mr. Eisenloeffel, an engineer with 19 years of experience working with water and wastewater systems in the State of Missouri, further described his review and assessment of the

DNR records reviewed by MAWC, to include communications MAWC personnel have had with DNR personnel. (Exh. 6, Eisenloeffel Sur.). While Staff has reviewed records, it does not appear that Staff personnel have had any conversations with DNR to better understand the conditions and implications of what they have reviewed. The is a deficiency in Staff's process as "[t]he letters and inspection reports must be considered in full to provide context." (*Id*. at p. 3).

For example, Staff suggests that Eureka has "problems with excessive inflow and infiltration (I&I) and sanitary sewer overflows (SSOs)." (Staff Ini. Brf., pp. 12-13). MAWC contacted DNR to explore this issue. While Eureka has been cited with a reporting violation as a condition of its operating permit, at no time does the MDNR conclude that I&I is "excessive." In fact, then DNR Compliance Chief, Kristi Savage-Clarke, came to the opposite conclusion. She found that I&I is not excessive per the federal regulations and her calculations. (Exh. 6, Eisenloeffel Sur., pp. 5-6, Sched. BWE-10).

Similarly, Staff alleges that the DNR reports show that "the system has failed to meet permit effluent limitations for biochemical oxygen demand (BOD) and total suspended solids (TSS) going back to at least October 2016" and "that the system has been, and likely continues to be, in violation of the permit effluent limits." (Staff Ini. Brf., pp. 11-12) (emphasis added). What Staff fails to explore, and what Mr. Eisenloeffel explains, is that the context of this violation and the permit modification that will be appropriate when MAWC acquires the system.

The DNR cites BOD and total suspended solids (TSS) "removal efficiencies." Limits and efficiencies are two completely different parameters found within the Eureka operating permit. (Exh. 6, Eisenloeffel Sur., p. 4). On July 10, 2019, Eureka met with DNR for compliance assistance on this subject. (*Id*.; also at Sched. BWE-9 (DNR memorandum documenting the meeting)). In this meeting, the DNR representatives agreed with the Eureka assessment that the

problem is a diluted influent or sewage that is too "clean" to meet a percent removal standard. (*Id*. at pp. 4-5).

Diluted influent is not a good indication of the condition of the sewer collection and treatment system. (Exh. 6, Eisenloeffel Sur., p. 5). Diluted influent at the sewer plant is merely an indication that a large amount of clean water is entering a sewer system. (*Id*.). Common sources would be a water main break, a large customer with very clean effluent, or inflow and infiltration (I&I). (*Id*.). In the July 10, 2019 compliance meeting, the DNR suggested that a permit modification could be appropriate and would put Eureka back in compliance. (*Id*.).

This suggestion was confirmed by MAWC in an email with MDNR Compliance Chief, Kristi Savage-Clarke. (Exh. 6, Eisenloeffel Sur., Sched. BWE-10). In that email, the calculations and regulations are discussed. Part of the calculations are those used to quantify inflow and infiltration. (*Id*. at p. 5). As discussed above, the Eureka inflow and infiltration calculations are below "excessive," as established by federal regulation limits, making the system eligible for such a permit change. (*Id*.). MAWC believes that a compliance violation that can be fixed with a change to the permit adjusting how BOD is measured does not indicate that a system is in poor condition. (*Id*.).

Additionally, since Staff's observations of the treatment plant, and contrary to other statements, Eureka has continued to make improvements and has undertaken a large portion of the work MAWC planned for the sewer system. (Exh. 7, Kaiser Dir., p. 8, as modified at Tr. 183 (Kaiser)). Eureka has replaced the air lines from the blower building to the lagoon to eliminate several air leaks, work was done on the basin to address surface boils, and repairs have resulted in reduced air flow requirements, allowing the system to operate on one blower rather than multiple blowers as it had in past visits. (Exh. 6, Eisenloeffel Sur., p. 7).

Ultimately, Mr. Eisenloeffel testifies that that the Eureka sewer collection system and the treatment systems are in good condition and the sewer treatment plant is operating and functioning as it was designed and permitted by the MDNR to do. (Exh. 6, Eisenloeffel Sur., p. 7). This is further consistent with the testimony of MAWC witness, who has over 35 years of experience in the water and wastewater design and construction industry. (Exh. 7, Kaiser Dir., p. 3). Mr. Kaiser stated as follows:

> I've never seen a sewer system in my 35 years that doesn't need work or doesn't have a letter from a DNR, an Illinois EPA, an Iowa Department of Environmental Protection that says this is things you need to do or there's an upcoming permit that's going to require modifications.· The system continues to age.· As it ages, things break, events happen, you fix them, you move on, and these are typical inspection reports and other correspondence.· So from our standpoint what we saw is not significant.

(Tr. 191-192 (Kaiser)).

Wells and Water Treatment Equipment

Staff further alleges a deficiency in the Flinn Report because it "fails to acknowledge that the wells and water treatment equipment will be functionally abandoned as part of the acquisition." (Staff Ini. Brf., p. 4). The fact that a future condition should not be considered in an "as is" appraisal and the lack of impact this has on fair market value is addressed in the "Future Use Not Appropriate for Consideration" section above. However, the statement is also inaccurate unto itself and MAWC will address the factual matters here.

MAWC witness Kaiser explained that while MAWC plans to supply the Eureka system with water from MAWC's St. Louis County water system, the existing wells in Eureka will be placed in a standby mode to serve as a back up to the single pipeline from St. Louis County. (Exh. 7, Kaiser Dir., p. 6). Similar to back-up power generation at MAWC's other treatment plants or pump stations, the wells and associated equipment will be available for use should the

pipeline be taken out of service due to a breakage, damage, or other incident which may interrupt water service to these approximately 4100 customers. (*Id*.). Any damage to the pipeline could result in service interruptions to the water system that may require some time to repair. (*Id*.). Without this back-up capability, Eureka could be left without a water supply while repairs are coordinated and completed. (*Id*.). If the wells were not used as a standby source, MAWC would need to consider a second pipeline or other redundant source of supply for the area. (*Id*. at pp. 6-7).

Moreover, while it is true the that actual wells will remain in service only as an emergency back-up to the proposed transmission main, the actual wells are only a small part of the existing water supply infrastructure and well site investments. (Exh. 8, Kaiser Sur., p. 3). Much of the equipment at the wells sites will continue to be used daily as part of the normal distribution system operations. (Exh. 7, Kaiser Dir., p. 7). Of the six (6) active well sites in Eureka, three (3) of them also include water storage tanks and booster pump stations that make up a large portion of the assets on these sites. (*Id*.) Three additional sites without active wells also include water storage tanks and booster pump stations. (*Id*.). These storge tanks and the booster pump stations will continue be used for the day-to-day operations of the Eureka water system after the completion of the pipeline from the St. Louis County system. (*Id*.). In addition to the storage tanks and booster pump stations, these sites have ancillary equipment such as chlorine storage and feed systems, pressure monitors, SCADA controls, and standby power generators which will be necessary and critical for the ongoing operations of the Eureka distribution system. (*Id*.; Exh. 8, Kaiser Sur., p. 3).

GIS Information as to Buried Assets

The Staff brief makes several accusations concerning the circumstances related to the GIS information utilized in the March 16, 2020 Flinn Report to more accurately estimate the age of the buried assets. MAWC described the differences between the approaches taken without, and with, the GIS Information maintained by St. Louis County[16] in its *Initial Brief*. (MAWC Ini. Brf., pp. 16-17).

As previously explained, the only change from the January report to the March report was the assumed age of buried infrastructure. (Exh. 9, Simpson Dir., p. 7; Tr. 209-211 (Simpson)). The January report was based on an assumption that 70% of buried assets were installed when portions of the systems were placed in service (water 1959 and sewer 1950), and that 5% was installed with the installation of each well (water distribution) and lift station (sewer). (*Id*.).

Subsequently, Derek Linam of MAWC made Ms. Simpson aware of the existence of certain GIS data maintained by St. Louis County that was relevant to the age of buried infrastructure.[17] (Exh. 9, Simpson Dir., p. 7; Tr. 209-211 (Simpson); Tr. 177 (Eisenloeffel); Tr. 185 (Kaiser)). Mr. Linam initially informed Ms. Simpson that he believed the growth rate of Eureka was possibly different than what had been assumed. (Tr. 214 (Simpson)).

Mr. Linam is an engineering manager for MAWC and lives in the general area of Eureka. He was aware of the availability of St. Louis County GIS information and suspected that the actual age of the infrastructure was different than what was assumed in the initial report. (Tr. 177 (Eisenloeffel); Tr. 185-186 (Kaiser)). The information was passed along because Mr. Linam

[16] Tr. 242 (Simpson)).
[17] Staff indicates that MAWC contacted Flinn Engineering about information which indicated an "increased value." (Staff Ini. Brf., p. 3). The information did not relate to "value," but to the age of buried infrastructure. Only the appraisers can estimate a value.

thought that it was important that the information contained in the Flinn Report be as accurate as possible. (Tr. 219-220 (Simpson); Tr. 178 (Eisenloeffel)).

Using the GIS data is a significantly more accurate and appropriate method of estimating the age of assets. (Exh. 9, Simpson Dir., p. 7). Here, it provided more reliable information than the assumption that 70% of the buried infrastructure was installed in 1959 and 1950, the traditional way of moving forward in the absence of such information. This is especially true given the pace with which Eureka has grown over the years. As of the 1960 census, Eureka's population was only 1,134.[18] As of 1970, it was 2,384;[19] as of 1980, it was 3,862;[20] in 1990, it was 4,683;[21] and, in 2000 it was 7,676;[22] and, as of 2010, it was 10,189.[23] The 2019 population of Eureka was estimated at 10,946.[24] At the 2020 Census, Eureka had a population of 11,646. (Exh. 1, Flower Dir., p. 3).

In order to assess the significance of this information, Ms. Simpson and Mr. Linam arranged a meeting where she could assess the GIS information maintained by St. Louis County and how it might differ from the assumptions made in the original report. (Tr. 216-217 (Simpson)). This was done so that Ms. Simpson could see the GIS data queries live and the responses from the St. Louis County system and would not be accepting data over an email. (Tr. 217 (Simpson)). This allowed her to confirm that the information came from St. Louis County and was not manipulated in any way. (*Id*.).

Ms. Simpson was able to initially see that by querying the number of parcels in Eureka with buildings, the number of parcels at that time (two years ago) was 3,925, which was

[18] *Official Manual of the State of Missouri*, 1963-1964, p. 1469.
[19] *Official Manual of the State of Missouri*, 1981-1982, p. 1199.
[20] *Id*.
[21] *Official Manual of the State of Missouri*, 2003-2004, P. 839.
[22] *Id*.
[23] *Official Manual of the State of Missouri*, 2011-2021, p. 613.
[24] Exh. 101, Gateley Reb., Sched. CBG-r2, p. 11 of 42.

consistent with the number of customers at that time (3,947 – as noted, Eureka continues to grow). (Tr. 218 (Simpson)). By following a similar approach for various time periods, Ms. Simpson was able to calculate percentages related to the build out of Eureka. (*Id*.). Ultimately, it appeared that 7.87% (rather than the originally assumed 70%) of the systems were built at the time the systems were placed into service (which was rounded up to 10% for purposes of the report. (*Id*.).

Staff attempts to paint this process as something lurid – "contact between MAWC and Flinn Engineering suggests that MAWC directed the final engineering report's content" (Staff Ini. Brf., p. 10); the "exchange suggests that the parties planned to experiment with values to obtain a different outcome" (Staff Ini. Brf., p. 18); and, it "suggest[s] that MAWC was involved in directing the process for producing the engineering report and was in control of its content" (*Id*.).

Perhaps the best response to these allegations is to point out what Staff does not say. Staff does not allege anywhere that the information used was inaccurate or irrelevant. It seems Staff's actual objection is that MAWC notified Ms. Simpson of the availability of more accurate information in regard to a transaction with a Missouri municipality, as evidenced in the following statement – "It runs counter to common experience that a prospective purchaser would seek to increase the purchase price." (Staff Ini. Brf., pp. 18-19).[25] In other words, Staff believes MAWC should have kept this accurate and relevant information to itself and tried to drive an artificially low fair market value for a Missouri municipality's assets.

[25] Staff also asks the question "if MAWC wanted the engineering report to contain the most accurate information, why did it not inform Flinn Engineering about known problems with the systems and DNR issues?" (Staff Ini. Brf., p. 19). As discussed in the "DNR Compliance Issues (Concerns Sewer System Only)" section of this Brief, MAWC has done its due diligence as to the DNR issue associated with the Eureka sewer system (this issue does not involve in any way the water system) and does not agree that that there are significant problems with the sewer system.

That may be the type of behavior one might expect in a stereotypical used car transaction. However, MAWC believes it is NOT the way a Missouri public utility should conduct itself - especially in regard to a transaction with a governmental entity. A municipality should be able to trust MAWC. Withholding material information, as suggested by Staff, would certainly be a violation of that trust. Hopefully, this is not the type of conduct the Commission would expect.

As to this situation, Mr. Batis, who does as many water/sewer appraisals as anyone, indicated that there was nothing out of the ordinary in this appraisal in terms of the involvement of Missouri-American or Eureka. (*Id*. at pp. 161-162 (Batis)). More importantly, Mr. Batis indicated that at no point did MAWC have any influence on the valuation opinion. (Tr. 161 (Batis)). The appraisers don't solicit or accept opinions from anyone as they are expected by their licenses and the USPAP to be objection and fair. (*Id*.) What the client thinks the property is worth is of no relevance to the appraisers. (*Id*.)

IMPACTS ON CUSTOMERS

Existing Customers

Staff suggests that MAWC is asking its existing customers to pay for the acquisition of the Eureka systems, plus additional upgrades. (Staff Ini. Brf., p. 20).

First, it is important to note that this outcome is intended by the statute. The statute contemplates the addition of the small utility to the large utility's existing customer base, even where the appraisal method is not used. Section 393.320.6 states that "[u]pon the date of the acquisition of a small water utility by a large water public utility, whether or not the procedures for establishing ratemaking rate base provided by this section have been utilized, the small water utility shall, for ratemaking purposes, become part of an existing service area, as defined by the public service commission, of the acquiring large water public utility. . . ." The statute is

designed to encourage the combination of small systems with large systems in order to achieve the benefits of economies of scale. Arguing against this result is merely an attempt to rewrite, or ignore, the statute.

Second, in this case, the per customer rate base associated with the Eureka systems is very similar to existing rate base. For the St. Louis County water tariff group, the change in rate base is 1.5%, and for the Other Missouri Wastewater tariff group, the change in rate base increase is 29.5% (and a 19.3% increase to the state-wide sewer rate base). (Exh. 11, LaGrand Dir., p. 9). The addition of the approximately 4,100 water and 4,100 sewer customers to St. Louis County and the Other Missouri sewer customers would be an increase in customers of 1.2% and 32.5%, respectively (statewide it would be an increase in customers of approximately .865% and 21.5%). Rate design in the next rate case, as decided by the Commission, would determine the actual rate impacts. However, this addition of rate base and customers should not have a significant rate impact for MAWC's St. Louis County water customers and may have a benefit for MAWC's Other Sewer customers.

In terms of payment for upgrades, it is also important to remember that once consolidated, this situation would be reciprocal, and Eureka customers would pay for capital investments made for existing MAWC customers. In MAWC's next rate case, the cost of service would consider the utility plant investments and expenses incurred by the tariff group as a whole. (Exh. 11, LaGrand Dir., p. 9). That means that existing MAWC customers will pay for capital investments made in Eureka, but it also means that Eureka customers would be paying for investments made outside of Eureka. By spreading the costs over a larger customer base, necessary improvements can be completed on smaller systems with minor impacts to other

customers. (*Id.*). Thus, when existing MAWC systems have capital needs, the newly acquired customers will help pay a portion of those costs.

No Acquisition Premium

Both OPC and Staff suggest that the transaction conducted in accordance with Section 393.320 will result in an "acquisition premium." (OPC Ini. Brf., p. 8). There is no acquisition premium associated with this transaction or that will result from this transaction.

Acquisition premium is generally the difference between the ratemaking rate base and the purchase price. Here, Staff believes an acquisition premium is represented by the difference between the appraised value and Staff's own calculation of net book value. (Exh. 12, LaGrand Sur., p. 8).

As explained in MAWC's *Initial Brief*, and above, Eureka's systems have no "net book value" and Staff's attempt to estimate one is greatly flawed. However, more importantly, since Section 393.320 states that the ratemaking rate base shall be the lesser of the appraised value or the purchase price, plus reasonable transaction costs, there would never be a difference between the purchase price and the rate base, and therefore there would never be an acquisition premium. (Exh. 12, LaGrand Sur., p. 8; Section 393.320.5(1) ("The lesser of the purchase price or the appraised value, together with the reasonable and prudent transaction, closing, and transition costs incurred by the large water public utility, shall constitute the ratemaking rate base. . . .").

This does not mean that the concept of "net book value" is completely ignored by Section 393.320. "[I]f the small water utility is a public utility subject to chapter 386 and the small water utility completed a rate case prior to the acquisition," the Commission may utilize the net book value determined by the Commission in its decision as to the ratemaking rate base. (Section

393.320.5(1)). That provision is **NOT AVAILABLE where the small water utility is a municipal system.**

OPC suggests "acquisition premium" is a relevant factor based on reference to *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n*, 120 S.W.3d 732, 736 (Mo. banc 2003) (concluding that when the Commission considers a merger under the analogous "detrimental to the public" standard found in RSMo. § 393.190.1, the Commission must consider "the acquisition premium . . . as a relevant and critical issue"). (OPC Ini. Brf., p. 7-8). Of course, the Eureka transaction does not involve Section 393.190. Further, the *AG Processing* involved two Missouri regulated entities – a situation where an acquisition premium would result. This case has no applicability to the Eureka transaction under Sections 393.170 and 393.320.

No Citizen "Payment"

Staff in various forms alleges that if allowed to progress, the transaction will result in "double recovery" for Eureka because "Eureka residents have already paid for the systems over the years through depreciation." (Staff Ini. Brf., p. 9-10; *see also* Staff Ini. Brf., , p. 7 (". . . many of the assets have been fully depreciated, indicating that the Eureka ratepayers have already paid for them."). This assertion is wrong on a variety of levels and, fundamentally ignores the fact that Eureka owns water and sewer systems that have value.

First, there is no evidence in this case how or on what basis, Eureka has set its rates. As has been noted many times, Eureka is not regulated and does not account for items in the way a regulated utility would and is not required to set its rates in the same way a regulated utility would. What a Eureka citizen may, or may not, have paid for through rates is completely undeterminable.

Second, what is clear, is that depreciation is NOT included in Eureka's accounting for the assets. Eureka does not capitalize and depreciate utility plant investments as an investor-owned utility would. (Exh. 12, LaGrand Sur., p. 4). Per the City's June 30, 2020, Audited Financial Statements:

> Capital outlays of the various funds are recorded as expenditures when incurred. These capital outlays represent the cost of land, buildings and improvements, and furniture and equipment. The City does not maintain a record of its capital assets for depreciation purposes.[26]

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

Third, even if Eureka customers could be said to have "paid" for the systems, as citizens, they are receiving value in that Eureka is selling the systems. Apparently, Staff believes that if Eureka citizens have "paid" for the systems, they should give the systems away for free. This makes no sense.

Lastly, and most importantly, this concept of depreciation has no relationship to the fair market value determination required by Section 393.320. "Fully depreciated" assets are not necessarily past the point of use. (Tr. 234-235 (Simpson)). And, if still in use, they have value. (*Id*. at 235).

Ultimately neither Eureka nor MAWC will receive a "windfall" under the proposed transaction, as alleged by Staff. (Staff Ini. Brf., p. 9). Eureka will receive the fair market value of the assets it owns and MAWC will reflect in rate base the actual amount it has paid for those assets.

[26] June 30, 2020, Audit of Financial Statements, page 27, subpart F.

CONDITIONS

Staff Conditions

This appears to not be an issue in controversy. MAWC has no objection to the conditions proposed by the Staff. (MAWC Ini. Brf., p. 12). If MAWC is granted the requested CCNs, Staff suggests the referenced conditions. (Staff Ini. Brf., p 20-21). OPC takes "no position." (OPC Ini. Brf., p. 9-10).

Service Areas

Likewise, there does not seem to be a dispute as to the district to which the Eureka customers should be added. MAWC takes the position that Eureka's now approximately 4,100 water customers should be added to the "St. Louis County" customer base of approximately 343,000 customers. And that Eureka's approximately 4,100 sewer customers should join the "Other Missouri" sewer rate category of approximately 8,500 customers.[27] (MAWC Ini. Brf., p. 12). Staff agrees with that assignment. (Staff Ini. Brf., p. 21). OPC recites the relevant statute but does not state a position as to what districts would be appropriate. (OPC Ini. Brf., p. 10).

CONCLUSION

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

[27] MAWC serves approximately 15,000 sewer customers state-wide.

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

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 28th day of February 2022, to:

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