

Exhibit No.: _____
Issue(s): Executive Compensation/Corporate
Governance/Third Party Contracts
Witness/Type of Exhibit: Schaben/Surrebuttal
Sponsoring Party: Public Counsel
Case No.: WR-2023-0006

SURREBUTTAL TESTIMONY
OF
ANGELA SCHABEN

Submitted on Behalf of the Office of the Public Counsel

**CONFLUENCE RIVERS UTILITY
OPERATING COMPANY, INC.**

CASE NO. WR-2023-0006

** _____ **
Denotes Confidential Information that has been redacted

July 21, 2023

PUBLIC

TABLE OF CONTENTS

Testimony	Page
Introduction	1
Executive Salaries	2
Corporate Governance	10
Third Party Contractors	19
Conclusion	24

SURREBUTTAL TESTIMONY

OF

ANGELA SCHABEN

CONFLUENCE RIVERS UTILITY OPERATING COMPANY, INC.

CASE NO. WR-2023-0006

1 **INTRODUCTION**

2 **Q. Please state your name, title, and business address.**

3 A. Angela Schaben, Utility Regulatory Auditor, Office of the Public Counsel (“OPC” or “Public
4 Counsel”), P.O. Box 2230, Jefferson City, Missouri 65102.

5 **Q. Are you the same Angela Schaben who filed direct and rebuttal testimony for the OPC
6 in this case?**

7 A. Yes.

8 **Q. What is the purpose of your testimony?**

9 A. The purpose of my testimony is to respond to Confluence Rivers (“Confluence” or “the
10 Company”) witnesses Brent Thies and Josiah Cox, on the subjects of executive
11 compensation, corporate governance, and third party contract management.

12 **Q. Please summarize your recommendations.**

13 A. I recommend the Commission disallow executive salaries from this rate case due to the
14 excessive nature of these salaries compared to other utilities operating within the State of
15 Missouri. Additionally, based on the overwhelming evidence related to the lack of formally
16 adopted policies and procedures, I also recommend the Commission order a third party
17 management report to identify Company inefficiencies including, but not limited to, internal
18 controls and potential procurement bias practices.

1 **EXECUTIVE SALARIES**

2 **Q. Which Company witness responded to the arguments raised in your direct testimony**
3 **regarding executive compensation?**

4 A. Josiah Cox.

5 **Q. What did Mr. Cox have to say regarding the issues surrounding executive salaries?**

6 A. Mr. Cox states the following “It is unquestioned that Missouri ratepayers receive a benefit
7 from the efforts of this management team. Most obviously, the executive team for which
8 Staff has removed all salaries and benefits for the team responsible for bringing 50 Missouri
9 systems back into compliance with health, safety, and environmental compliance.”¹

10 **Q. Do you agree with Mr. Cox’s assertion?**

11 A. Not particularly. After reviewing the Company’s goals as stated in objectives and key results
12 (“OKRs”), it’s clear that Confluence considers identifying and obtaining more systems to be a
13 higher priority than long term planning related to maintenance. For example, the Company
14 does not have a long term strategy or 5 year plan for capital investments, though it now seems
15 willing to develop one in order to qualify for WSIRA.² The Company’s focus on acquiring
16 new systems and lack of long-term planning of its current systems leads me to believe
17 Confluence’s management team is not providing any real benefit to its current Missouri
18 customers who are left in the care of third-party operators to oversee their day-to-day needs.

¹ Cox Rebuttal, page 34, lines 1-5.

² Cox Rebuttal, page 29, line 20 through page 30, line 2.

1 **Q. Mr. Cox finds your executive salary analysis flawed because “there’s little value in**
2 **comparing the executive salaries for a rapidly growing water and wastewater utility to**
3 **those of largely static electric and gas utilities” because the board of directors “of any**
4 **relevant industry will look for experience that is applicable to that specific industry.”³**
5 **What is your response?**

6 A. While it is certainly true that a utility would value experience related to its specific industry
7 sector when hiring or promoting members of the executive class, this has little to no relevance
8 to the point made in my direct testimony. What I presented in my direct testimony was a *per*
9 *customer* salary comparison that showed the impact executive salaries had on individual
10 customers for the leading utilities in this state. This allowed the data to be standardized among
11 those utilities despite each serving a different number of customers. That testimony
12 demonstrated that the impact executive base salaries have on customers, when standardized on
13 a per customer basis, falls within a reasonable range for most major Missouri public utilities.
14 Confluence, however, is and remains an outlier, which demonstrates how its executive salaries
15 are unreasonable.

16 Mr. Cox’s attempt to rebut my point in direct actually only emphasizes the inequity in
17 the salaries being paid to Confluence’s executives. For example, Mr. Cox cites the years of
18 experience for the current CEOs of Ameren (21 years), Evergy, and Spire (40 years) in his
19 rebuttal testimony.⁴ He goes on to try and argue that this extensive experience makes
20 comparison between these CEOs and Mr. Cox’s own personal salary an “apples-to-oranges”
21 comparison, but he fundamentally misses the point. All of these CEOs, despite having far
22 greater experience than Mr. Cox (based on what Mr. Cox appears to be arguing), are being
23 paid far less than Mr. Cox on a per customer basis. Stop and consider that for a moment. All
24 of these executives, which Mr. Cox emphasizes have more experience, are being paid less than
25 what Confluence is paying its executive class (when considered on a per customer basis). That

³ Cox rebuttal, page 37, lines 15-18.

⁴ Cox rebuttal page 38 line 2 – page 39 line 6.

1 is the fundamental point of my original direct testimony and the fundamental flaw in Mr. Cox's
2 rebuttal. The entire executive base salary analysis was done to show how Central States Waster
3 Resources ("CSWR") executive salaries greatly exceed the executive salaries of established,
4 non-chaotic, operating utilities within the State of Missouri. Moreover, the executives working
5 for these static, non-chaotic utilities are employing and managing full time employees to carry
6 out business operations. This is in stark contrast to Confluence River's executives as the
7 Company relies heavily on third-party contractors to handle the majority of its day-to-day
8 operations.

9 **Q. Do you agree that the salaries of other water executives are a better point of comparison**
10 **than electric or water utilities?**

11 A. I think it depends. My analysis actually included at least one Missouri water utility and this
12 utility fell at the lower end of the scale in comparison to CSWR. Like I stated previously, if
13 we are going to compare like with like, the most accurate comparison would include a water
14 utility operating with the same model as CSWR.

15 **Q. Did Mr. Cox offer an alternative water utility for comparison?**

16 A. Yes. Mr. Cox offered a comparison of CSWR executive salaries to a "similarly sized national
17 water / wastewater" utility, Middlesex Water Company.

18 **Q. What similarities do CSWR and Middlesex Water Company?**

19 A. It would appear that the only major similarity is that they are both considered small water
20 companies. There are also, however, significant differences between CSWR and Middlesex
21 Water Company.

22 **Q. How does Middlesex Water Company differ from CSWR?**

23 A. First of all, Middlesex is a publicly traded water company that's been around for over 100
24 years, since 1897. This company's business model has had the time to evolve to what's in
25 existence today and it's subject to Security and Exchange Commission ("SEC") rules.
26 Additionally, Middlesex has two overall business segments and includes both regulated and

1 non-regulated water and waste water services. The main difference here is that CSWR is using
2 contractors to operate and maintain its regulated operations, whereas Middlesex is providing
3 contracted services to non-regulated private and municipal water and wastewater systems, in
4 addition to its regulated operations. Another key difference here is that Middlesex Water
5 Company is located in New Jersey, a state with a higher cost of living than Missouri.

6 **Q. So the example of the Middlesex Water Company CEO salary is not an appropriate**
7 **comparison to the CSWR CEO salary?**

8 A. I don't think so. According to Mr. Cox, the Middlesex Water Company CEO receives a 2022
9 annual paid salary of \$700,000, and additional compensation of \$399,000 in restricted stock
10 awards. What Mr. Cox failed to address is the cost of living difference between Iselin, New
11 Jersey (Middlesex Water Company) and St. Louis, Missouri (CSWR).⁵ In the first quarter of
12 2023, Missouri is listed as number four out of 52 for cost of living while New Jersey is number
13 41. Additionally, the Missouri utility index is 97.7 while New Jersey's is 107.2, meaning the
14 cost of utilities in New Jersey is more expensive.

15 **Q. Factoring in cost of living between Iselin, NJ and St. Louis, MO, what is the difference?**

16 A. According to salary.com, the cost of living in St. Louis is 25% less than in Iselin, NJ and
17 employers in St. Louis typically pay 12.2% less than employers in Iselin, NJ.⁶ In other words,
18 the St. Louis, Missouri equivalent of a position earning \$700,000 in Iselin, NJ, is \$614,278.
19 Mr. Cox's 2022 base salary not only ****_____**** both the \$700,000 salary of
20 Middlesex Water Company's CEO, it also ****_____**** St. Louis's cost of living
21 adjustment equivalent. As you read this statement, keep in mind that Middlesex Water
22 Company⁷ has been in existence since 1897, building an industry reputation and evolving to
23 meet industry challenges for over one hundred years. In retrospect, CSWR has only been in

⁵ Missouri Economic Research and Information Center. (2023). *Cost of Living Data Series*. Retrieved from MERIC:
<https://meric.mo.gov/data/cost-living-data-series>

⁶ Schedule ADS-S-1

⁷ <https://www.middlesexwater.com/about-us/our-services/>

1 operation since 2014⁸ and operates on a unique business model not widely adopted in the water
2 utility industry.

3 **Q. Mr. Cox mentioned non-salary compensation received by the Middlesex Water**
4 **Company CEO. Did the CEO and other executives of CSWR receive additional**
5 **compensation in addition to base salary during the test year?**

6 A. Yes. CSWR appears especially focused on growth through acquisitions and provides generous
7 bonuses for system acquisitions. However, Mr. Cox and the executive team also receive equity
8 based compensation. In 2021, Mr. Cox received approximately ****_____**** in equity
9 compensation. In 2022, CSWR executives received equity compensation in the approximate
10 amount of over ****_____****⁹ Let's compare this executive compensation of CSWR to
11 the same level of compensation received from the CEO of Middlesex Company based in Iselin,
12 NJ. As mentioned before, in 2022, Middlesex's CEO received \$399,000 in non-salary
13 compensation which equates to around \$350,139 for a St. Louis, Missouri CEO.¹⁰ Mr. Cox's
14 2021 non-salary compensation thus ****_____**** that of the Middlesex's CEO 2022
15 non-salary compensation.

16 **Q. Does Mr. Cox offer any other alternative water utility for comparison?**

17 A. Yes. He references Artesian Resources, which is Delaware utility. Most of the same concerns
18 that I raised with regard to Middlesex Water Company apply equally to Artesian Resources.

⁸ See Schedule ADS-S-2 showing articles of incorporation for First Round CSWR, LLC dated 01/23/2014. On 05/17/2019, First Round CSWR, LLC was renamed as CSWR, LLC.

⁹ CSWR external audit work papers of RSM.

¹⁰ Salary.com salary comparison for the \$399,000; Schedule ADS-S-3

1 **Q. Do you believe that “the salaries and benefits for CSWR executives are very reasonable**
2 **and well within the mainstream” of water and wastewater utilities such as Middlesex**
3 **Water Company and Artesian Resources?**

4 A. No. Beside the fact that both Middlesex Water Company and Artesian Resources¹¹ are
5 publicly traded, mature water companies that have been in business for over one hundred years,
6 both of these companies are based in States with a higher cost of living.

7 **Q. You mentioned the CSWR’s generous bonus structure related to business development**
8 **and system acquisitions. Does this type of pay also affect Confluence employee**
9 **compensation costs?**

10 A. Yes. The Company’s objectives and key results (“OKRs”)¹² place great emphasis on growth
11 through identifying and acquiring distressed systems. In fact, the CSWR business
12 development bonus structure is designed to **_____**
13 _____ .** More connections within an acquired system,
14 **_____** Therefore, business development incentive awards provide
15 employees motivation for identifying and acquiring larger systems, especially if connections
16 **_____**

17 **Q. How are the Company’s OKRs related to Mr. Cox’s executive salaries and benefits**
18 **rebuttal testimony?**

19 A. Mr. Cox’s rebuttal testimony includes an amount of **_____** for CSWR 2022
20 executive base salaries. He arrives at this amount by removing a voluntary 10.8% reduction
21 in salary to “account for executive supervision of business development efforts.”

¹¹ <https://www.artesianwater.com/about-artesian/>

¹² OKRs are used to provide a framework for businesses to accomplish their goals - Hennigan, L. (2023, 05 19). *What Is An OKR? Definition & Examples*. Retrieved from Forbes: <https://www.forbes.com/advisor/business/what-is-an-okr-definition-examples/>

¹³ Found in external auditor workpapers.

1 **Q. Have you reviewed the Company’s objectives and key results (OKR)?**

2 A. Yes, I have reviewed CSWR’s OKRs from 2019 through the first quarter of 2023.

3 **Q. Did the Company OKRs outline goals related to “bringing 50 Missouri systems back**
4 **into compliance with health, safety, and environmental compliance”?**

5 A. Not that I could tell. CSWR’s OKRs show the company’s top goals for this time period focus
6 mainly on Company growth and distressed system acquisition, employee retention, and
7 developing an ESG report.¹⁴

8 **Q. What does CSWR’s OKRs say about the Company?**

9 A. CSWR is hyper focused on growth through the acquisition of distressed systems, becoming a
10 top water and wastewater utility, and developing a report that public companies generally put
11 together in order to attract investors keen on ESG initiatives¹⁵. Unfortunately, the Company’s
12 single minded focus on growth could be considered detrimental to existing customers who
13 have experienced diminished services¹⁶.

14 **Q. Does CSWR’s fixated mission to identify and acquire distressed systems and the business**
15 **development incentives awarded have the potential to harm ratepayers?**

16 A. Ratepayers could be harmed in more ways than one. First of all, any corporate costs, or
17 incentive pay, related to business development, if allowed in rate base, harms customers
18 because these costs do not add value to their water or wastewater services. Customers should
19 not be subjected to costs for which they are receiving no benefit in return. Consequently, as
20 CSWR’s internal operations and organizational structure currently stands, the organization
21 itself is management top heavy, and since nearly all services provided to and by the Company
22 are contracted out, it’s very difficult to determine what exactly most CSWR staff business

¹⁴ ADS-S-4; Several examples of Company OKRs between 2019 and 2022

¹⁵ Complying with ESG principles expands opportunities for attracting investors focused on ESG initiatives.

¹⁶ Testimony of Mr. Stephen Raye, resident of Fox Run Subdivision; June 26, 2023 local public hearing, page 6 line 19 through page 8 line 11.

1 duties are. Especially, since contractors complete most of the work and many key reports and
2 initiatives identified as part of internal employee job descriptions have not yet been
3 developed.¹⁷

4 **Q. Are there any other Comments made by Mr. Cox to which you wish to respond?**

5 A. On Page 32, lines 12 through 19, Mr. Cox seeks to provide an excuse for why Confluence's
6 executive team did not provide timesheets, as mentioned by Staff. Specifically, he cites the
7 Kentucky Commission's recognition that economies of scale should occur with a larger rate
8 base. While I agree with the Kentucky Commission on a high level, economies of scale have
9 not resulted in meaningful decreases for the CSWR salaries allocated to Missouri. This is likely
10 due to the 43% to 68% base salary increases received by the executive staff in 2022 and other
11 duplicative expenses incurred by the overlap of duties between internal staff and external
12 contractors.

13 **Q. What did Staff recommend regarding expenses related to business development?**

14 A. As reiterated in the revised accounting schedules, Staff recommended removing expenses
15 related to business development.

16 **Q. Do you agree with Staff's recommendation?**

17 A. Yes.

18 **Q. Based on your analysis of CSWR's OKRs would you recommend the removal of more
19 than the Company's 10.8% voluntary reduction of supervisory business development
20 efforts?**

21 A. Absolutely. The OKR's show that CSWR's executive team clearly places top priority on
22 business development and system acquisition over plans for long term maintenance of the same
23 systems.

¹⁷ ADS-S-5; Company response to OPC data requests regarding certain employee job functions.

1 **Q. What is your recommendation?**

2 A. I recommend that the Commission remove expenses related to CSWR executive salaries and
3 benefits from this case. Mr. Cox’s executive salary comparison of CSWR to Middlesex Water
4 Company and Artesian Water does not factor in cost of living differences, the difference in
5 business models, or differences in maturity levels between a utility that’s existed approximately
6 ten years vs utility companies successfully operating for over a century. I also support Staff’s
7 recommendation relating to salary disallowances.

8 **CORPORATE GOVERNANCE**

9 **Q. Which Company witnesses responded to the concerns you raised in direct testimony**
10 **regarding Confluence River’s corporate governance deficiencies?**

11 A. Company witness, Mr. Brent Thies responded to my corporate governance deficiency concerns
12 raised in direct testimony.

13 **Q. What general observations have you made regarding these witnesses’ responses to your**
14 **direct testimony?**

15 A. I have noticed a reoccurring theme within the testimonies of the Company witnesses I’ve
16 reviewed – a theme centered around the fact that CSWR’s business model concentrates on
17 acquiring distressed water systems. Much of the Company’s testimony focuses on its mission
18 to keep acquiring distressed systems and that its rapid growth of distressed systems should
19 excuse the Company from complying with day-to-day tasks like timekeeping. Examples of
20 this can be found in the testimony of Josiah Cox, page 31 lines 11 through 19 and page 32 lines
21 6 through 9.

22 **Q. Do you agree that Confluence’s continued expansion should excuse Confluence from**
23 **maintaining proper day-to-day operations as the Company suggests?**

24 A. No. Serving its existing customers through proper day-to-day operations should be the primary
25 focus of any Missouri water utility.

1 **Q. In his rebuttal testimony, Mr. Thies responds to your criticism regarding the Company’s**
2 **lack of formal accounting policies by stating the Company follows Generally Accepted**
3 **Accounting Principles (“GAAP”) and the National Association of Regulatory**
4 **Commissioners (“NARUC”) Uniform Systems of Accounts and that the Company’s**
5 **“accounting records and the policies that underlie them are subject to comprehensive**
6 **audit by state utility regulators.”¹⁸ What are your thoughts?**

7 A. I find this statement interesting considering the difficulty of determining the reliability of
8 Company supplied responses to data requests relating to invoices or transparency into the
9 decision making process used to determine vendor selection. Testimony of Staff witness Ms.
10 Jane Dhority stated that Staff could not conduct a lead/lag study in time for rebuttal testimony,
11 in part, because Confluence was still working to put together missing invoices as of the
12 technical conference held on June 14, 2023. Staff was still requesting missing invoices as of
13 June 21, 2023.¹⁹ Based on this information, Confluence’s system and policies related to
14 accounting records does not seem to meet regulatory standards since we are now on surrebuttal
15 testimony, the final written testimony in this case, and it’s anyone’s guess whether or not the
16 Company has yet supplied Staff sufficient information to conduct its lead/lag study.

17 Further, I disagree with the idea that GAAP and the NARUC Uniform System of
18 Accounts justify Confluence’s failure to develop sufficient formal accounting policies. Both
19 of these items represent broad, overall frameworks that can be applied to utilities and utility
20 regulators. However, it would still be necessary for individual utilities to develop written
21 accounting policies and procedures that define how it specifically intends to comply with
22 GAAP and the Uniform System of Accounts.

¹⁸ Brent Thies rebuttal, page 21.

¹⁹ Jane C. Dhority rebuttal, pages 1 and 2.

1 **Q. What is your response to Mr. Thies’ assertion that CSWR has never received**
2 **communication from its external audit firm indicating “significant concerns about**
3 **CSWR’s control, control environment, or fraud risks” since Mr. Thies began working**
4 **with Confluence in 2016?**²⁰

5 A. Mr. Thies also states that “[w]hile a comprehensive analysis of internal financial controls and
6 fraud risk is not part of the basic scope of a financial audit, the controls and risk are assessed
7 to help set audit parameters and procedures.” An external financial statement audit is not
8 designed to conduct an in depth assessment of internal controls and would have to be
9 designed around the existing environment. And despite unqualified opinions for both years,
10 during the planning stage for both the 2021 and 2022 financial statement audits, CSWR’s
11 external auditor identified the following ****_____****
12 during initial risk assessment procedures²¹: ******

13
14 ******
15 **Q. Does ****_____** and ****_____******
16 **_____ **** constitute potential fraud risks?****

17 A. Yes. The Public Company Accounting Oversight Board (“PCAOB”) provides guidance for
18 public accountants and auditors relating to “the process of identifying and assessing risks of

²⁰ Brent Thies rebuttal, page 22.

²¹ External auditor planning letters, confidential; Please see Schedule ADS-S-6

1 material misstatement of the financial statements.”²² The PCAOB classifies the risks identified
2 by CSWR’s external auditor as potential fraud risks. Determining the magnitude of these risks
3 is decided by the external auditor conducting the risk assessment. However, PCAOB staff
4 have raised concerns regarding external auditors’ application of professional skepticism in
5 areas such as management judgement, further observing that “some auditors sought to obtain
6 only evidence that would support judgements or representations made by management” and
7 “failed to critically take into account all relevant evidence, regardless of whether it confirmed
8 or contracted management’s assertions.”²³

9 **Q. Are you suggesting that CSWR’s unqualified external audit opinions are clouded by a**
10 **lack of professional skepticism?**

11 A. Of course not. I don’t have evidence to suggest such a thing. I am merely attempting to
12 reconcile the fact that CSWR received unqualified audit opinions relating to their financial
13 statement audits despite the fact that external auditors identified **_____

14 _____ ** in the audit planning letters for 2021 and 2022.

15 **Q. Since an external financial statement audit does not fully evaluate internal controls, how**
16 **would these be measured?**

17 A. For most entities, internal auditors would more extensively evaluate internal controls. In some
18 cases, a third party management audit is necessary in order to maintain objectivity.

²² Public Company Accounting Oversight Board. (2023). AS 2110: Identifying and Assessing Risks of Material Misstatement; <https://pcaobus.org/oversight/standards/auditing-standards/details/AS2110>. Washington, DC, United States.

²³ Brewster, CPA, Ph.D., B. E., Butler, CPA (inactive)/CITP, CGMA, Ph.D., J. B., & Watkins, CPA, Ph.D., A. L. (2019, 08 01). Eliminating Biases that Jeopardize Audit Quality. *Journal of Accountancy*, <https://www.journalofaccountancy.com/issues/2019/aug/biases-jeopardize-audit-quality.html>

1 **Q. Does CSWR task internal auditors or any other staff member with internal control**
2 **review?**

3 A. Not that I have found. Mr. Thies's testimony only mentions the reliance upon external annual
4 financial statement auditor's limited opinion on internal controls.

5 **Q. If internal CSWR staff are not conducting internal control reviews, how would the**
6 **Company know for sure if their internal controls are effective?**

7 A. That's a great question. My direct testimony outlines deficiencies in CSWR's corporate
8 governance practices and pointed out particular inadequacies relating to non-existent formal
9 policy and procedures documentation and the Company's inconsistent procurement practices.
10 In rebuttal, Mr. Thies acknowledges that CSWR policies and procedures are not documented.²⁴
11 The Company apparently does follow some informal, undocumented policies and procedures,
12 they just aren't in writing.

13 **Q. Do you consider this to be sufficient?**

14 A. Not at all.

15 **Q. Why not?**

16 A. There are plenty of historical examples that show the importance of maintaining good, written
17 internal policies.

18 **Q. Could you provide an example?**

19 A. Certainly. Let us consider the Savings and Loans crisis of the 1980s and 1990s. In 1982,
20 President Ronald Regan signed the Garn-St. Germain Depository Institutions Act, leading
21 to deregulation of Savings and Loan Institutions ("S&L") lending, which resulted in "riskier

²⁴ Brent Thies rebuttal page 21.

1 commercial real estate and even riskier junk bonds,”²⁵ and zombie thrifts.²⁶ As a result,
2 “the combination of deregulated lending and capital requirements along with a taxpayer-
3 funded guarantee backstop created an enormous moral hazard in the S&L industry. S&Ls
4 were allowed to take greater risks and incentivized to do so excessively. The result was
5 rapid growth in the industry along with ballooning speculative risk.”²⁷ Charles Keating,²⁸
6 a prominent figure of the S&L crisis, utilized a financial structure seemingly devised to
7 both satisfy S&L regulators while also extracting cash.

8 **Q. What does the S&L crisis and Zombie banks have to do with CSWR’s questionable**
9 **existence of adequate internal controls?**

10 A. It’s relevant for a multitude of reasons. First of all, the S&L crisis persisted longer than
11 necessary because the government backed speculative lending was caused by a lack of internal
12 controls at the banks. Following the crisis, the United States General Accounting Office
13 (“GAO”) called for “annual audits of insured institutions and reports on their internal
14 controls and compliance with laws and regulations.”²⁹ The GAO also found that certain
15 other steps should be taken to improve the quality of audits and to enhance the financial and
16 other information that insured institutions submit to the regulators.”³⁰ Additionally, GAO
17 suggested the following:

²⁵ Kenton, W. (2021, 07 30). *Savings and Loan Crisis (S&L): What Happened and Aftermath*. Retrieved from Investopedia: <https://www.investopedia.com/terms/s/sl-crisis.asp>

²⁶ Zombie thrift or zombie bank is a term used to describe an insolvent financial institution whose balance sheet consists of large amounts of nonperforming loans, leading to reduced cash flows and earnings. Only Government support allows these institutions to continue operating, since losses are assured by government guarantees. Zombie bank is used to describe the S&L crisis when the government initially continued to back S&Ls despite crippling losses. Ultimately the responsibility of paying for zombie bank losses fell upon the taxpayers. (See ADS-S-7)

²⁷ Kenton, W. (2021, 07 30). *Savings and Loan Crisis (S&L): What Happened and Aftermath*. Retrieved from Investopedia: <https://www.investopedia.com/terms/s/sl-crisis.asp>

²⁸ Charles Keating established American Continental Corporation (“ACC”). In 1984 ACC acquired Lincoln Savings & Loan.

²⁹ United States General Accounting Office. (1990, 04 06). *Resolving the Savings and Loan Crisis: Billions More and Additional Reforms Needed*. Retrieved from GAO.gov: <https://www.gao.gov/assets/t-afmd-90-15.pdf>; See also Schedule ADS-S-8

³⁰ *Id.*

1 In many cases, regulators and the deposit insurer lack the necessary financial and
2 other information to assess institutions' financial condition and the adequacy of their
3 internal controls and compliance with laws and regulations. Insured institutions must
4 be required to provide better information in these areas. Therefore, we have
5 recommended, and continue to recommend, that insured institutions be required to
6 undergo annual financial audits and issue management reports on the effectiveness
7 of internal controls and their compliance with safety and soundness laws and
8 regulations. To provide assurance on the validity of the management reports, we also
9 recommend that, as part of the annual audit, auditors be required to review and report
10 on management's assertions contained in its reports³¹.

11 **Q. Based on this passage what did the GAO recommend in light of the S&L failures?**

12 A. The GAO recommended that insured institutions issue management reports on the
13 effectiveness of internal controls in addition to the annual financial statement audit.
14 Additionally, the external auditors should review and report on management's internal control
15 assertions.

16 **Q. Does the GAO have further recommendations?**

17 A. The GAO also recommended the requirement for institutions to establish audit committees,
18 "which play an important role in preventing and detecting fraudulent financial reporting and
19 overseeing internal controls."³²

20 **Q. Does CSWR have an independent audit committee?**

21 A. Not that I am aware. While CSWR did hire accounting employees recently, most of the
22 accounting functions referenced in this case were completed by outside audit firms.

³¹ *Id.*

³² *Id.*

1 **Q. Absent applying the GAO recommendations regarding assessment of internal controls,**
2 **what could occur?**

3 A. Lots of questionable practices could occur absent the existence of formal governance and
4 internal control monitoring. For instance:

5 You set up an organization such that it will legitimately pay out a percentage of its
6 value to you through dividends, bonuses, and commercial transactions with other
7 controlled entities, then you blow up the size of that entity to an absurd level by
8 taking on a load of debt and let the normal and legitimate mechanisms of the
9 corporation transfer the fraudulent value into your pocket.³³

10 **Q. What would happen if a business entity was set up with a system of incentives and**
11 **non-existent checks and balances allowing a natural progression of deceptive**
12 **inflation?**

13 A. That's a great question that is actually asked in a riveting book written by Mr. Dan Davies, a
14 former regulatory economist. The answer to this question is equally informative and stresses
15 the importance of governance, effective management, and internal controls:

16 If you were lucky enough to set up a company with bad incentives and internal
17 controls by accident, then you would get nothing but positive reinforcement for
18 your decision for quite a while – it would look like the company was profitable, it
19 would grow at a snowballing rate, and in that sort of situation, what senior manager
20 would question whether or not he deserved a big bonus? Hypothetically, it could
21 be possible for a massive control fraud to take place purely by accident, without
22 any criminal responsibility for the overall scheme at all. This would present a really
23 unattractive case; there would be an appalling amounts of criminality and
24 misrepresentation, but all of it would be able to credibly claim that they were not

³³ Davies, D. (2021). Chapter 7: Control Frauds; The Savings and Loan Scandals. In D. Davies, *Lying for Money: How Legendary Frauds Reveal the Workings of the World* (p. 288). New York, NY: Scribner: An Imprint of Simon and Schuster, Inc.

1 sophisticated enough to realize that what they were doing was illegal. Meanwhile,
2 you would have a top tier of rich senior managers, who should have known what
3 was going on, and about whom everyone has a strong suspicion that they “must
4 have known,” but no possibility whatsoever of anyone being able to meet criminal
5 standards of evidence of them having to do so, because they in fact didn’t know.”³⁴

6 **Q. Would any other concerns exist relating to the previous passage?**

7 A. Yes. Concerns relating to vendor bias and subsequent kick-backs. To return to the S&L crisis
8 example explained above, Mr. Keating managed to inflate property prices since he only utilized
9 property appraisers who gave him the results he wanted. A very similar concern could easily
10 occur in the regulated utility industry when seeking services for things such as engineering
11 reports that are used to support additional capital investments on which the utility will
12 ultimately earn a return. For instance, let’s consider CSWR and Confluence River’s
13 relationships with third party vendors and contractors – especially the relationships with
14 multiple companies who are owned, operated, founded by the same individuals – such as 21
15 Design Group and Midwest Water Operations, LLC. This is a Company with few formally
16 written policies and procedures, yet the entire business model of CSWR and its affiliates
17 essentially relies upon the services of third party contractors. This is an important topic that I
18 will return to later in my testimony.

19 **Q. What do you recommend?**

20 A. I recommend the Commission order Confluence Rivers to develop satisfactory internal
21 controls and require a third party management audit at the expense of shareholders. An annual
22 external financial statement audit does not sufficiently identify all areas where internal controls
23 may be lacking. If CSWR continues on its path of aggressive systems acquisitions, the
24 Company should be required to provide regulators assurance that the Company can prudently
25 manage all of these systems for the benefit of ratepayers.

³⁴ *Id.*

1 **Third Party Contractors**

2 **Q. What is Nitor Billing Services?**

3 A. Nitor Billing Services provides customer call center services and billing services.

4 **Q. How does Company witness Mr. Brent Thies describe Nitor in his rebuttal testimony?**

5 A. Mr. Thies refers to Nitor as the contractor that “has served our affiliate group since its
6 beginnings, and there is a substantial benefit to both our affiliates and our customers to
7 ensuring we provide a good and consistent customer service experience whether the
8 customer is from Missouri or any of the other states where our group provides service.” He
9 further argues that “[i]t makes no sense and is administratively infeasible, based solely on
10 the outcome of a competitive bidding process, for one customer service vendor to serve
11 Missouri customers and another to serve customers in Louisiana or Tennessee.”³⁵

12 **Q. What does that statement signify?**

13 A. I can’t say for sure. Nitor Billing Services appears to provide some level of services to other
14 CSWR affiliates in addition to Confluence Rivers. Though, in this case, contract negotiating
15 at the CSWR level makes more sense, in order to achieve economies of scale, before allocating
16 contractual cost to affiliates based on a customer count allocator.

17 **Q. Is it plausible that Nitor has “served our affiliate group since its beginning”?**

18 A. Sure. Based on documents found on the Missouri Secretary of State’s website, Articles of
19 Incorporation for CSWR were filed on January 27, 2014 while Articles of Incorporation for
20 Nitor Billing Services, LLC were filed on April 30, 2015.³⁶ It is plausible that Nitor has served
21 CSWR since it was officially formed on April 30, 2015.

³⁵ Rebuttal Testimony of Brent Thies, page 23.

³⁶ Schedule ADS-S9

1 **Q. Is Nitor Billing Services, LLC the only Nitor business entity?**

2 A. No. It appears that an entity named Nitor Utility Services, LLC was also created on April 30,
3 2015 by Mr. Mark Peterman, also the founder of Nitor Billing Services, LLC.

4 **Q. Are there connections between the CSWR President and CEO and the Nitor Billing**
5 **Services President and CEO?**

6 A. Nitor Billing Services, LLC founder Mark Peterman's association with CSWR's President
7 Josiah Cox goes back to at least 2009, when they both served on the board of Mission: St.
8 Louis together.³⁷ The registered agent name for each Nitor entity related to Mr. Peterman is C
9 T Corporation System, which is the same registered agent utilized by CSWR and Confluence
10 Rivers. Additionally, Mr. Peterman's LinkedIn profile points to CSWR as a "team of former
11 business associates."³⁸ Mr. Peterson is also the President & CEO of Cornerstone Solutions
12 Group, another vendor that CSWR utilizes.

13 **Q. Does Cornerstone Solutions group also have a contract with CSWR?**

14 A. Not that I have found. However, I did identify **_____** in outgoing payments to
15 Cornerstones Solutions Groups, Inc. made by CSWR from 12/20/2019 through 1/11/2023.

16 **Q. Do you agree with Mr. Thies' assertion that Nitor has provided a quality service that**
17 **customers demand?**

18 A. No. Mr. Thies does state that CSWR works "with Nitor on a daily basis to ensure it provides
19 the level of service our customers and regulators demand, and we're convinced we are
20 paying a fair price for the services that vendor provides."³⁹ However, customer testimony
21 contradicts these statements.⁴⁰

³⁷ Mission St. Louis is a not for profit. See Schedule ADS-S-10

³⁸ Schedule ADS-S-11

³⁹ Rebuttal Testimony of Brent Thies, page 23.

⁴⁰ LHP Customer testimony frequently mentions the inability to connect with a customer service representative and/or threats of service disconnect due to incorrect billing statements. See Camdenton LPH Transcript page 57, lines 2 through 13. See Farmington LPH Transcript, page 13 line 22 through page 16 line 23; page 49 lines 5 through 15;

1 **Q. How did Confluence Rivers determine that Nitor is paid a fair price for its services?**

2 A. The Company never bid out the Nitor contract and has failed to provide an adequate response
3 explaining how it is determining the fair-market price for those services. In the absence of such
4 a bid, I must therefore conclude that Confluence Rivers cannot conclude that it has paid a fair
5 price for Nitor's services.

6 **Q. Would Confluence Rivers' customers agree with Mr. Thies' assertion that some factors,
7 such as experience, are as important as selecting the lowest bidder?**

8 A. I think it depends on the quality of service the customers actually receive relative to the amount
9 they are subjected to pay for their water and/or sewer services consequent of the contractual
10 expenses accumulated by the Company, in some cases for potentially overlapping and/or
11 duplicative services.⁴¹ Market research suggests that, regardless of income, most customers
12 are willing to pay for quality products and customer service.⁴² If Confluence Rivers
13 endeavored to invite a wider selection of operations and maintenance vendors to bid, rather
14 than the usual vendors who have been getting the bid for years as a result of potentially biased
15 procurement, the Company could contract with vendors that provide quality service
16 satisfactory to customers. For example, Hillcrest residents, have been paying exorbitant rates
17 for approximately ten years. Some prospective homebuyers decide against buying in this area
18 due to the steep rates, which exceed water and sewer rates in nearby communities.⁴³ Therefore,
19 customer testimony tells a tale of sub-par water quality and practically non-existent customer
20 service, which contradicts Mr. Thies's claims.

page 66 lines 7 through 16; page 66 line 21 through page 67 line 19; page 71 lines 7 through 15; page 75 line 13 through page 76 line 16.

⁴¹ There's still a question about which services liveVOICE and Nitor actually provide since Confluence billing services have reportedly been moved in-house as of June 2022 and Confluence's data request responses remain ambiguous.

⁴² Hyken, S. (2021, 08 29). *Customers Will Pay More For This*. Retrieved from Forbes: <https://www.forbes.com/sites/shephyken/2021/08/29/customers-will-pay-more-for-this>

⁴³ LPH transcripts

1 **Q. Does Staff question whether Nitor Billing Services exists in real life?**

2 A. Based on rebuttal testimony submitted by Ms. Jane Dhority, Staff attempted to contact
3 representatives of Nitor Billing Services and was unsuccessful. At one point, based on the
4 manner in which a Nitor representative answered the phone, Staff questioned whether the
5 person indeed worked for Nitor. Equally disconcerting is the fact that the Nitor representative
6 hung up after Staff asked legitimate questions related to pricing structures, and never returned
7 Staff's phone call.

8 **Q. Is this type of behavior normal for a customer service and billing company?**

9 A. I should hope not. This type of behavior elicits severe concerns regarding the ability or
10 willingness of Confluence, and/or its third-party vendors, to communicate with both customers
11 and regulators. This is reinforced by statements made by customers in both written and verbal
12 comments made during the local public hearings.

13 **Q. Are there additional vendors CSWR utilizes without contracts that perhaps should be**
14 **bid out?**

15 A. Yes. One relationship that springs to mind is the Company's ongoing dealings with 62Archer.

16 **Q. What is 62Archer?**

17 A. According to its website, 62Archer is in the business of Inspection and Consulting.

18 **Q. What is the nature of the relationship between CSWR and 62Archer?**

19 A. According to the Company responses to OPC data request 1102, 62Archer "conducts tank
20 inspections as well as collecting and reviewing bids for the tank rehab activities that are
21 approved by Confluence Rivers."

22 **Q. Which party initiated the business relationship between CSWR, Confluence Rivers, and**
23 **62Archer?**

24 A. According to the Company's response to OPC data request 1159, "62 Archer approached
25 Confluence Rivers to inquire if the Company needed a vendor for tank inspections. After

1 initial conversations progressed, the [Company's internal] Director of [Environmental,
2 Health, and Safety ("EHS")] requested to review the reports that would come from the
3 inspection. After a review of the reports, the Director contracted 62 Archer to inspect a tank
4 as a trial. Upon completion, the work was deemed satisfactory and the decision to utilize 62
5 Archer for additional tank inspections was made."

6 **Q. Does 62Archer assist CSWR with additional duties?**

7 A. According to the Company's response to OPC DR 1160 "62Archer provides
8 recommendations for repairs for water storage tanks, and when given the approval to move
9 forward, will seek out qualified contractors to complete the work. This includes reviewing
10 the bids and providing CSWR with their recommendations based on the cost and previous
11 work done by the submitting parties."

12 **Q. Are these services that could potentially be completed by one of the Company's other
13 contractors?**

14 A. One would think so. The Company has been in business for several years now and already
15 contracts with a wide spectrum of contractors, such as 21 Design Group, whose owner also
16 owns Midwest Engineering. It doesn't make sense that the Company needs one more
17 contractor(s) whose purpose is reviewing the bids of other additional contractors who actually
18 complete the work.

19 **Q. Could other vendors in the area also complete such services and submit bids to complete
20 these services?**

21 A. Yes. There are plenty of seemingly qualified vendors who are considered competitors of
22 62Archer⁴⁴.

⁴⁴ See page 2 of Schedule ADS-S-12 for a list of 62Archer competitors.

1 **Q. What is your recommendation?**

2 A. Clearly Confluence Rivers faces challenges relating to managing third-party vendor
3 relationships in a manner that eliminates procurement bias.⁴⁵ In light of these challenges, I
4 reiterate the need for a management audit completed by an independent consultant in order to
5 identify potential deficiencies, and recommend the Commission order one at the expense of
6 the Company.

7 **Conclusion**

8 **Q. Is there anything else you would like to say?**

9 A. Mr. Cox's response to customer concerns shows how out of touch the Company is with regard
10 to managing the systems it has rapidly acquired. Confluence's business model revolves more
11 around acquiring systems than it does managing the systems it acquires. The Company relies
12 heavily on contracts with third-party vendors, some of whom have past connections the
13 Company's management team,⁴⁶ and occasionally without engaging in a proper RFP process,
14 thereby suggesting contract bias. As a result, the Company performs poorly with regard to
15 long term planning, customer communication, and addressing ongoing customer concerns.

16 Mr. Cox's dismissal of Port Perry customer comments as "largely irrelevant to this rate case,"⁴⁷
17 is frankly insulting to customers and shows just how out of touch he is with the real people
18 CSWR has been tasked to serve under Commission orders. As CSWR customers are aware,
19 local public hearings resulting from a rate case are the only time where they are truly heard.⁴⁸

⁴⁵ Procurement bias is defined as "using inappropriate criteria or information in decision making that leads to irrational, arbitrary, and capricious decisions which may lead to deliberate bias in the form of a preconceived, prejudiced perspective intended to weigh for or against certain choices". See Forbes publications found in Schedule ADS-S-13

⁴⁶ For example, Nitor Billing Services

⁴⁷ Josiah Cox rebuttal testimony, page 9

⁴⁸ Testimony of Brandy McIntire, Resident of Hillcrest, June 14, 2023 Virtual Public Hearing, page 7, lines 19-25 through page 10, lines 1-19. Ms. McIntire has been paying between \$150-\$200 per month for around ten years now and acknowledges some improvements but still cannot drink the water because of high chlorine and it doesn't taste right. She still buys drinking water from the store and, like many Confluence Rivers customers who testified at local public hearings, had to purchase several hot water heaters since residing there. She spoke out at the local

1 It's only natural for Port Perry residents to speak out against what they could be expected to
2 pay for water and sewer service relative to the customer service and consideration they are
3 actually receiving from the Company. Port Perry is a community that cares about its residents,
4 communication, and service quality. Port Perry residents, and other communities CSWR
5 acquired, are real people who have to either live with the consequences of the Commission's
6 decision, or leave their community in search of more affordable options. Though if their water
7 and sewer rates are so unreasonable in comparison to neighboring communities, the difficulty
8 in finding buyers willing to pay the same is challenging.⁴⁹

9 **Q. Does this conclude your testimony?**

10 A. Yes.

public hearing so "other communities don't have to go through what we've been going through" in hopes that she would be heard by the Commission.

⁴⁹ Testimony of Thomas Bridges, resident of Hillcrest, June 14, 2023 Virtual Public Hearing, page 15, lines 9-25, page 16, lines 1-15.

