

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

In the Matter of the Application of Confluence Rivers            )  
Utility Operating Company, Inc., for Authority to                )  
Acquire Certain Water and Sewer Assets and for a                )  
Certificate of Convenience and Necessity                            )  
**File No. WA-2019-0299**

**CONFLUENCE RIVERS’ REPLY BRIEF**  
**AS TO NET BOOK VALUE**

**COMES NOW** Confluence Rivers Utility Operating Company, Inc. (“Confluence Rivers” or “Company”), and as its *Reply Brief As To Net Book Value*, states as follows to the Missouri Public Service Commission (“Commission”):

**TABLE OF CONTENTS**

INTRODUCTION ..... 1  
ISSUE 2 ..... 4  
    PUBLIC INTEREST ..... 4  
    SPECULATIVE AND UNREALISTIC SCENARIOS..... 7  
    CONFLUENCE RIVERS’ CURRENT INVESTMENT ..... 9  
    CONFLUENCE RIVERS WILL NOT “OVERPAY” ..... 10  
    APPROPRIATENESS OF THE TRANSACTION..... 12  
CONCLUSION..... 14

**INTRODUCTION**

Initial briefs as to the net book value (“NBV”) of the Port Perry Service Company (“Port Perry”) assets have been filed in this case by the Staff of the Commission (“Staff”), Office of the Public Counsel (“OPC”), and Lake Perry Lot Owners’ Association (“Association”).

Given that the Association and OPC have veered from the specific issue for which the

record has been reopened – the NBV of the Port Perry assets – a few matters from Confluence Rivers’ earlier briefs bear repeating. That is, there is no serious challenge in this case to the qualifications of Confluence Rivers to own and operate the Port Perry assets in a safe and adequate manner. This is not surprising as Confluence Rivers is an existing public utility currently operating 9 water and 9 sewer systems in Missouri in a safe and adequate manner. (Exh. 1, Cox Dir., p. 4, ll. 16-18). Confluence Rivers has already acquired small Missouri water and sewer companies, brought capital to improve those systems, upgraded the services provided to customers, and delivered safe and adequate service. (Exh. 5, Cox Sur., p. 9). It currently serves approximately 630 sewer customers and 540 water customers. (Ex. 602).

The Central States Water Resources (“CSWR”) family of companies currently provide water or wastewater service to over 35,000 connections serving more than 100,000 people across four states. (Ex. 600, Cox NBV Reb., p. 5; Ex. 602; Tr. 395 (Cox)). CSWR and its utility operating affiliates have approximately \$63 million of total capital investments in their 172 water and sewer systems. (*Id.*; Tr. 396 (Cox)).

In this case, the following benefits justify a finding of no detriment:

- Confluence Rivers, an experienced and current owner and operator of multiple water and sewer systems, would acquire the systems;
- Confluence Rivers is an owner/operator with a solid track record of rehabilitating, maintaining and operating small water and sewer systems;
- Confluence Rivers’ financial and technical resources are sufficient to provide improved service options for customers;
- Confluence Rivers is a part of a larger organization of affiliated utilities that

allows it to bring economies of scale to the bidding of larger projects, which allows the attraction of more bidders and more competitive pricing (to include local bidders), the use of experts and operating personnel, and the purchasing of supplies for the systems. (Tr. 37-38, 66-67, Cox); and,

- Confluence Rivers' ownership will result in continued regulation of operations and rates by the Commission to ensure safe and adequate service at just and reasonable rates.

As to the first issue in the *List of Issues, List and Order of Witnesses, Order of Opening, and Order of Cross-Examination* filed on May 15, 2020 - the net book value of the Port Perry assets - there is no disagreement among the parties. The net book value of the Port Perry assets as of December 31, 2019, for purposes of this case, should be a total of \$77,936 (\$20,070 for water assets, and \$57,866 for wastewater assets).

As to the second issue – whether, given the NBV of the Port Perry assets, the proposed acquisition is not detrimental to the public interest -- the Staff's NBV Initial Brief takes the position that there is no detriment associated with the NBV of the Port Perry assets or its relationship to the purchase price for the following reasons:

The Association and OPC confuse purchase price and net book value. Because the Commission will not allow Confluence to include an acquisition premium in rates, the assets' net book value does not create a detriment. The Missouri Court of Appeals stated in *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz* that the “[t]he Commission may not withhold its approval of the disposition of assets unless it can be shown that such disposition is detrimental to the public interest.” This evidence of net book value, combined with Staff's analysis of the TMF capacities and the Tartan Factors, make plain that Confluence's acquisition of the Port Perry systems and CCNs is not detrimental to the public interest, and the Commission must approve the transaction.

(Staff NBV Ini. Brf., p. 7).

The NBV initial briefs of the OPC and Association take contrary positions as to the detriment issue. Confluence Rivers responds to the Association and OPC briefs in the following paragraphs.

## ISSUE 2

**Given the answer to the first question, should the Commission find that Confluence Rivers Utility Operating Company, Inc.'s ("Confluence Rivers") acquisition of the Port Perry Service Company's ("Port Perry") water and wastewater assets and certificates of convenience and necessity is not detrimental to the public interest, and approve the transaction?**

Confluence Rivers will address the following issues:

- 1) The Association's erroneous allegation that the Commission has misinterpreted and misapplied the law in the Commission's traditional treatment of what constitutes "the public interest" based on *State ex rel Mo. Pac. Freight Transport Co. v. Public Service Commission*, 295 S.W.2d 128 (Mo. 1956) (Assoc. NBV Ini. Brf., p. 3-6);
- 2) The Association's list of speculative and unrealistic "scenarios" given the impact of the Commission's well-established and statutorily required rate making and oversight processes (Assoc. NBV Ini. Brf., p. 9-10);
- 3) The Association's erroneous and misleading attack on the amount of Confluence Rivers' current investment in its existing systems. (Assoc. NBV Ini. Brf., p. 8);
- 4) OPC's allegation that Confluence Rivers will overpay for the Port Perry assets; and,
- 5) The Association's and OPC's questions as to why the proposed transaction is appropriate for Confluence Rivers.

## PUBLIC INTEREST

As stated above, the Association alleges that the Commission has misinterpreted and

misapplied the law in the Commission’s traditional treatment of what constitutes “the public interest.” The specific Commission approach with which the Association takes issue is as follows:

The public interest is a matter of policy to be determined by the Commission. It is within the discretion of the Public Service Commission to determine when the evidence indicates the public interest would be served. . . . In making such a determination, the total interests of the public served must be assessed. This means that some of the public may suffer adverse consequences for the total public interest. Individual rights are subservient to the rights of the public. The "public interest" necessarily must include the interests of both the ratepaying public and the investing public; however, as noted, the rights of individual groups are subservient to the rights of the public in general.

(Assoc. NBV Ini. Brf., p. 4).

The Association references *State ex rel Mo. Pac. Freight Transport Co. v. Public Service Commission*, 295 S.W.2d 128 (Mo. 1956) and the *Declaration of Independence* for its proposition that the rights of the “regulated entity” are “subservient” to the public interest.

(Assoc. NBV Ini. Brf., p. 5).

The Association refuses to recognize that the buyers and sellers have constitutional property rights in these transactions. The Commission’s review of these types of matters, in fact, begins with the constitutional concept of property rights – the owners of property have a constitutional right to determine whether to sell their property or not, as identified by the Missouri Supreme Court. “To deny them that right would be to deny them an incident important to ownership of property. A property owner should be allowed to sell his property unless it would be detrimental to the public.” *State ex rel St. Louis v. Public Service Commission*, 73 S.W.2d 393, 400 (Mo. 1934), citing *City of Ottawa v. Public Service Commission*, 288 Pac. (Kan.) 556 (emphasis added).

This standard was further explained by the Missouri Supreme Court as follows:

To prevent injury to the public, in the clashing of private interest with public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be *benefited*, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public *detriment*. 'In the public interest,' in such cases, can reasonably mean no more than 'not detrimental to the public.'

*State ex rel. St. Louis v. Public Service Commission*, 73 S.W.2d 393, 400 (Mo. 1934).

What the Association misses, and what the Commission has gotten correct in the past, is that the interests of all individual groups are subservient to some extent to the interests of the public in general. All of these groups (the seller, the purchaser, customers of the seller, customers of the purchaser), and subgroups (residential customers, commercial customers, industrial customers), and groups that may be separate altogether from the sellers, purchasers and their customers (users of the waterways of Missouri and non-customers that use the water and sewer systems such as travelers and visitors) have rights and interests – some similar and some adverse to others. Thus, while it is true that the interests of an applicant may be subservient to a broader “public interest” (at least, in an acquisition case where after weighing of benefits and detriments it is found that a proposed acquisition is detrimental to the public interest), it is also true that the interests of all other groups are also, ultimately, subservient to that same interest.

The Association wants to create an impossible standard to apply – that every individual interest be considered the “public interest.” However, the Commission has considered the public interest previously and reasonably found as follows:

“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."

\*\*\*\*\*

The public interest is a matter of policy to be determined by the Commission. It is within the discretion of the Public Service Commission to determine when the evidence indicates the public interest would be served. Determining what is in the interest of the public is a balancing process. In making such a determination, the total interests of the public served must be assessed. This means that some of the public may suffer adverse consequences for the total public interest. Individual rights are subservient to the rights of the public. The "public interest" necessarily must include the interests of both the ratepaying public and the investing public; however, as noted, the rights of individual groups are subservient to the rights of the public in general.

*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). *See also, State ex rel. Pub. Water Supply Dist. No. 8 v. Pub. Serv. Com.*, 600 S.W.2d 147, 154 (Mo. Ct. App. 1980) ("It needs to be pointed out that it is within the discretion of the P.S.C. to determine when the evidence indicates the public interest will be served in the award of a certificate to a competing utility." (emphasis added)).

The Commission has neither misinterpreted, nor misapplied the law as to the public interest.

### **SPECULATIVE AND UNREALISTIC SCENARIOS**

The Association lists what it describes as "five main scenarios for [recovery of acquisition premium], all of which should be a concern for the Commission." (Assoc. NBV Ini. Brf., p. 9-10). The Staff accurately observes there is "no evidence that these things will actually occur, or even that they are likely to occur." (Staff NBV Ini. Brf., p. 6). Further, each of the "scenarios" reveals a certain misconception about the Commission's regulatory process and each

would require abrogation of statutes or rules that define the Commission's duties and responsibilities in order to bring about any detriment for the customers.

The scenarios allege that the acquisition might cause Confluence Rivers to become overleveraged, jeopardize service, foster self-dealing, encourage gold plating, and/or Confluence Rivers will unfairly spread the acquisition premium among all Confluence Rivers customers. (Assoc. NBV Ini. Brf., p. 9-10). These scenarios do not recognize that Confluence Rivers must charge only those rates the Commission allows it to charge, as determined within a rate case before the Commission.

The Association's concerns are completely misplaced within the regulatory process in Missouri. Sections 393.130 and 393.140, RSMo, mandate that the Commission ensure that all utilities are providing safe and adequate service and that all rates set by the Commission are just and reasonable. A public utility has no right to fix its own rates and cannot charge or collect rates that have not been established by the Public Service Commission, *May Department Stores Co. v. Union Electric Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 57 (1937). Further, Section 393.150.2, RSMo, makes clear that at any hearing involving a requested rate increase the burden of proof to show the proposed increase is just and reasonable rests on the corporation seeking the rate increase.

Section 393.190 and Section 393.200, RSMo, require Commission authorization before Confluence Rivers may enter into evidence of indebtedness or encumber its assets.

All construction projects are examined within the context of a rate case to determine whether that construction was prudent. Once challenged, "[t]he utility then has the burden of showing that the challenged items were indeed prudent. Prudence is measured by the standard of



reasonable care requiring due diligence, based on the circumstances that existed at the time the challenged item occurred, including what the utility's management knew or should have known.” *In the Matter of Missouri-American Water Company*, Report and Order, p. 41, Case No. WR-2000-281 (August 31, 2000).

As to affiliate transactions, the Missouri Supreme Court has noted that that no presumption of prudence should apply to affiliate transactions, in part, “because of the greater risk of self-dealing when contracting with an affiliate.” *Office of the Pub. Counsel v. Mo. PSC*, 409 S.W.3d 371, 376-77 (Mo. 2013). Thus, such transactions are given greater scrutiny.

Thus, in regard to the Association’s scenarios, there is no avenue for Confluence Rivers to hide an acquisition premium. The Association’s list of scenarios and the protections offered by the regulatory process do, however, highlight the benefits to the Port Perry customers associated with the fact that Confluence Rivers’ ownership will result in continued regulation of operations and rates by the Commission to ensure safe and adequate service at just and reasonable rates.

### **CONFLUENCE RIVERS’ CURRENT INVESTMENT**

The Association relies on Confluence Rivers’ 2019 Annual Report for allegations that are, to use its own words, “deceptive if not completely wrong.” The Association cites information found on page 4 of the Confluence Rivers Annual Report for the fact that the NBV of Confluence Rivers as of December 31, 2019, was \$561,518. However, that was not the totality of Confluence Rivers’ investment. Also on page 4 of the 2019 Annual Report is a listing of “Water Construction Work in Progress” in the amount of \$1,429,322; “Sewer Construction Work in Progress” in the amount of \$1,961,346; plus cash, accounts receivable and other assets

totaling \$4,318,872, as of December 31, 2019. Five months of operation have passed since the relevant date for purposes of the annual report.

Moreover, the Association's reference to Confluence Rivers' negative net income reported in the Annual Report ignores pending matters. Confluence Rivers initiated a rate case on August 29, 2019 (File No. WR-2020-0053),

The Commission issued its *Order Approving Unanimous Disposition Agreement and Small Company Rate Increase With Accompanying Tariffs* in File No. WR-2020-0053 on April 8, 2020. However, prior to the issuance of that order, on March 30, 2020, the Commission directed the parties in File No. WR-2020-0053 to respond to a proposal to delay the effective date of the tariffs due to the COVID-19 pandemic and its related economic disruptions. Confluence Rivers responded affirmatively that it would voluntarily delay the effective date of the tariffs to July 1, 2020. Thus, the rate increase identified in that case will begin to address the net income issue until bills including the new rates go out in August of this year.

### **CONFLUENCE RIVERS WILL NOT "OVERPAY"**

The OPC's allegations that the proposed transaction is detrimental to the public interest because of its belief that Confluence Rivers has overpaid are demonstrably incorrect.

First, OPC's allegations are based solely on a comparison of the purchase price to NBV. This represent a basic misunderstanding of how parties to a transaction arrive at a mutually satisfactory purchase price. Generally, the purchase price should reflect the fair market value of the assets being purchased not their NBV. The "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 arms-length transaction." *In the Matter of Atmos Energy Corporation's 2008-2009*

*Purchased Gas Adjustment and Actual Cost Adjustment*, 2011 Mo. PSC LEXIS 1400, \*16 (Mo. P.S.C. December 21, 2011).

While the NBV of regulated properties is certainly a factor that likely is taken into account by the parties to such transactions, it is not sole factor used to establish a fair market value. In fact, it is common in water and sewer acquisitions for there to be an acquisition premium in the price paid by purchasers of such systems. (Tr. 388, Cox).

Moreover, there are other metrics, such “cost per customer,” that are considered by purchasers and markets. (Tr. 389, Cox). And when those metrics are considered, it is clear Confluence Rivers did not overpay for the assets it proposes to acquire. Confluence Rivers provided a comparison of price per customer for various Missouri transactions. (Exh. 601C and Exh. 900). That information shows that the Confluence Rivers/Port Perry transaction compares very favorably with those other transactions as its price per customer is on the far low end of that range. (Exh. 601C and Exh. 900).

First, as to the Lawson transaction, and as noted in Exhibit 900, Lawson employed the special “appraisal” acquisition mechanics found in RSMo. § 393.320 as a surrogate for a traditional net book value calculation. No such appraisal was performed for the Port Perry assets. Had such an appraisal been performed on the Port Perry assets, it cannot be determined how that appraised value would compare to the net book valued agreed to by the parties to this case.

Second, as to the Wardsville transaction, the parties are not aware precisely how the balances were derived or how those balances may compare to Port Perry’s NBV, given that the Staff Recommendation filed on March 13, 2017, noted “that Wardsville plant records do not

appear complete with respect to MAWC's need to keep plant records in accordance with the National Association of Regulatory Utility Commission (NARUC) Uniform System of Accounts." (Staff Recommendation, File No. WA-2017-0181, Memorandum page 5 of 9 (March 13, 2017)).

The evidence in this case indicates that the purchase price represents fair market value as it is the price that Port Perry is willing to accept and Confluence Rivers is willing to pay on the open market in an arms-length transaction. That is not an overpayment and, as explained in Confluence Rivers *Initial Brief As To Net Book Value*, its relationship to NBV will have no impact on the customers as no acquisition premium will be sought for recovery.

#### **APPROPRIATENESS OF THE TRANSACTION**

Both the Association and the OPC question generally why Confluence Rivers would pursue this transaction. This, of course, is not a part of the standard to be applied by the Commission. However, it is a question that Confluence Rivers has answered previously.

At the NBV hearing, Confluence Rivers' witness Cox provided a description of the mission of Central States in regard to small water and sewer systems.

. . . there are two reasons why we still want to do consummate this transaction. One is that Port Perry, is, you know, the typical type of system that we specialize in. They are under 500 individual connections. And really our company, our mission vision, is to bring safe and reliable water resources to every committee in the US. And small communities, particularly those under 500, they really represent the communities that are most at risk for a lack of safe and reliable service.

In fact, you know, the American Waterworks Association in 2015 talked about how many safe water – clean drinking water violations were over 80,000. Of those 80,000 violations, 70,000 of those were to communities with less than 500 connections. And really those violations, you know, half of those are serious violations. So you think, you know, E. Coli in the water, a lack of -- you know, boil advisories and that kind of thing. And so those communities represent over

50 percent of the serious drinking water violations in the country.

We know that these are the type of communities that really need a professional utility provider, somebody that's got industry experience, the financial, technical, and managerial wherewithal to manage them over a long period of time. So that's one reason.

\* \* \* \*

And Confluence Rivers has continued to acquire systems under the same company. So we know that we have the wherewithal to deal with this system. We know that we are the right company to go provide safe and reliable service to these customers. . . .

(Tr. 379-380, Cox).

This is CSWR's business model and so far, it has resulted in a family of companies that have over 35,000 water and sewer connections. Port Perry fits that model. However, additional information is found in Mr. Cox' Direct Testimony in this case:

The level of experience and expertise CSWR currently provides affiliated systems in Missouri and Arkansas, and that it would bring to Confluence Rivers if the Application is approved, is not usually available to small systems like those at issue in this case. But CSWR's business model provides these assets to its affiliates and does so through the economies of scale that CSWR's centralized management structure can achieve, at a lower cost than would be the case if Confluence Rivers or a similarly-sized company had to acquire or provide such expertise and support on its own.

(Ex. 1, Cox Dir., p. 7).

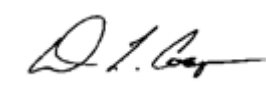
By acquiring systems like Port Perry, Central States and Confluence Rivers continue the process of bringing economies of scale to small water and sewer systems. Port Perry has approximately 370 water connections and 250 sewer connections to add to a Confluence Rivers' current 547 water customers and 636 sewer customers. (Ex. 602). These types of acquisitions are very important to continuing to bring economies of scale to small systems.

## CONCLUSION

For the reasons stated herein, and in Confluence Rivers' previously filed *Initial Brief*, *Reply Brief*, and *Initial Brief As To Net Book Value*, the Commission should find that Confluence Rivers' acquisition of the Port Perry water and wastewater assets and certificates of convenience and necessity is not detrimental to the public interest and approve the transaction.

**WHEREFORE**, Confluence Rivers respectfully submits its *Reply Brief As To Net Book Value* for consideration of the Commission.

Respectfully submitted,



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## CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail, on June 9, 2020, to the following:

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