

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

In the Matter of Confluence River Utility )  
Operating Company, Inc.'s Request for )  
Authority to Implement a General Rate )  
Increase for Water Service and Sewer )  
Service Provided in Missouri Service )  
Areas )

**File No. WR-2023-0006**  
Tracking Nos. YW-2023-0113  
and YW-2023-0114

**INITIAL BRIEF OF**  
  
**CONFLUENCE RIVERS UTILITY**  
  
**OPERATING COMPANY, INC.**

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September 8, 2023

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**INITIAL POST-HEARING BRIEF OF  
CONFLUENCE RIVERS UTILITY OPERATING COMPANY, INC.**

COMES NOW, Confluence Rivers Utility Operating Company, Inc. (“Confluence Rivers” or the “Company”), by and through the undersigned counsel, pursuant to the Commission’s *Order Granting Motion to Amend Procedural Schedule* and provides this Initial Post-Hearing Brief. On August 29 and September 1, 2023, various unopposed stipulations were filed which limit the number of issues awaiting Commission resolution. As such, the Commission is asked to decide the following issues: (1) Issue 4: Income Taxes; (2) Issue 6: Acquisition-Related Costs; (3) Issue 8: Timesheets; (4) Issue 13: Cost of Capital; (5) Issue 16: Advanced Meter Infrastructure Investments; and (6) 17(d): Operations, Maintenance, and Oversight. Thus, Confluence Rivers submits the attached Initial Brief on those issues awaiting decision.

## I. INTRODUCTION

In its opening statement, Confluence Rivers explained to the Commission the “big picture” underlying the Confluence Rivers / CSWR mission statement.<sup>1</sup> Specifically, in the opening statement, Confluence Rivers detailed for the Commission the national problem with fragmented water and wastewater systems unable to meet increasingly stringent environmental requirements.<sup>2</sup> Because the vast majority of these fragmented systems are small, distressed, regulated systems or unregulated municipalities / homeowners’ associations, they lack the financial, technical, and managerial capability to upgrade and operate these systems in a manner to ever meet such environmental requirements. Missouri is not immune to this problem. In fact, Missouri suffers from a disproportionate number of small, distressed water systems.<sup>3</sup> As a result, a large number of Americans, and Missourians, are denied the basic water service that they deserve.

As the agency statutorily charged with ensuring that customers receive “safe and adequate” service,<sup>4</sup> the Commission will inevitably be looked upon to implement policies and make decisions that promote the acquisition and rehabilitation of these distressed water systems. While justifiably expected to help solve this problem,<sup>5</sup> Staff and Public Counsel<sup>6</sup> have proven to be of little

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<sup>1</sup> CSWR, LLC. (“CSWR”) is the parent company to Confluence Rivers’ Missouri operations. In addition, CSWR has utility operating affiliates in Kentucky, Louisiana, Texas, Arkansas, Tennessee, Mississippi, Arizona, North Carolina, Florida, and South Carolina. (Exhibit 4, Cox Direct, page 3).

<sup>2</sup> Tr. Volume 8, pages 10-33.

<sup>3</sup> As Mr. Cox points out in response to Public Counsel’s characterization of CSWR’s mission statement as “We Buy Ugly Houses,” “such a characterization demonstrates how little OPC witness Marke, and the OPC in general, understands about the gravity of the situation Missouri customers face in terms of health and safety when they are served by failing water and wastewater systems.” (Exhibit 5, Cox Rebuttal, pages 2-3).

<sup>4</sup> See, Section 393.130, 393.145, 393.146 and 393.320. See also, *In the Matter of Osage Utility Operating Company, Inc.*, 637 S.W.3d 78 (Mo.App. 2021).

<sup>5</sup> To date, Confluence Rivers has been responsive to alleviating the Commission’s problem with regulated water systems that were not providing safe and adequate service. “Confluence Rivers has purchased at least 13 regulated utilities that were languishing through DNR enforcement actions and / or receiverships. These 13 utilities do not include all the purchased regulated systems with historical MDNR health and safety violations because that list would be close to comprehensive of all the regulated systems purchased to date by Confluence Rivers.” (Exhibit 5, Cox Rebuttal, page 7).

<sup>6</sup> As Mr. Cox asserts, Public Counsel has been of little value in helping to ensure that distressed, regulated were restored to a state in which they could provide safe and adequate service. “Similarly, these were systems with customers which Public Counsel professes to represent and, despite such representation, for which Public Counsel

assistance to the Commission. Specifically, when questioned whether any of its positions were formulated with an eye towards resolving this national and state challenge, Staff readily admitted that no one on Staff “would be concerned” with “how [Staff’s positions] would impact future acquisitions.” Thus, the Commission is clearly on its own when it comes to addressing this problem.

Q. And relative to the witness that -- witnesses that have appeared in this case, you would supervise all those auditors; is that correct?

A. The auditors, yes.

Q. Okay. So Mr. Majors, Ms. Lyons, Amenthor, Dougherty, Sarver, all of those; is that correct?

A. That is correct.

Q. And would you review their testimony?

A. I do review their testimony.

Q. Okay. And so you're -- you are familiar with the positions in that testimony?

A. Yes, I am.

Q. Do you consider how those positions may reflect on a bigger policy of trying to encourage acquisition of distressed systems?

A. I do not.

Q. Okay. So in this case, for Staff, who would consider how auditing positions may impact acquisition or non-acquisition of distressed systems?

A. *I don't know that anybody on Staff would be concerned with what auditing's positions are and how they would impact future acquisitions.*<sup>7</sup>

Public Counsel’s positions are even more disconcerting. Not only has Public Counsel not adopted policies that assist in the acquisition and rehabilitation of distressed systems, Public Counsel has been steadfastly opposed to Confluence Rivers’ efforts to address these problems.

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was doing little, if anything, to ensure had safe and adequate service.” (Exhibit 5, Cox Rebuttal, page 7). Thus, Confluence Rivers is the only entity assisting the Commission in ensuring that customers are receiving safe and adequate service.

<sup>7</sup> Tr. Volume 9, pages 125-126 (emphasis added).

Josiah Cox certainly has had some management training and achieved some experience along with having some technical expertise in the field, but he has little, if any, experience in the operation a (sic) Commission regulated public utility company. . . Public Counsel does not know the answers to these questions, but is **greatly concerned that the proposed financing, as currently structured, could be detrimental to the utility, and to the public.** . . The unusual nature of the financing proposed by the buyer along with its owners (sic) lack of knowledge and experience operating a regulated public utility company suggests that the Commission should move cautiously in authorizing the requests sought in this case. . . Public Counsel recommends that the Commission not entertain any additional acquisitions or mergers by Mr. Cox and / or his group of affiliates until such time as they have had the opportunity to go through at least one full rate case cycle. . . **Public Counsel recommends that the Commission order Josiah Cox and his group of affiliates not to enter into or request of the Commission authorization of any additional acquisitions or mergers of small water or sewer operations in this State** until they have completed one full rate case cycle.<sup>8</sup>

While Public Counsel's obstruction has, at various times, ranged from simply refusing to entertain stipulations<sup>9</sup> to the outright opposition of other acquisition applications,<sup>10</sup> its obstruction has been ever present.

Despite the regulatory obstacles constructed by Staff and Public Counsel, Confluence Rivers has now acquired,<sup>11</sup> with the *Commission's* assistance, 68 distressed water / wastewater systems in the state of Missouri.<sup>12</sup> As a result of the Commission's assistance, thousands more Missourians now have access to safe, reliable and environmentally responsible water resources. The following case studies from the Indian Hills water system and Missouri Utilities water and

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<sup>8</sup> Rebuttal Testimony of Ted Robertson, Case No. WO-2014-0340, filed October 3, 2014, pages 13, 16, 17, 18, and 19-20 (emphasis added).

<sup>9</sup> See, Case Nos. SM-2015-0014 and SM-2017-0150.

<sup>10</sup> See, WA-2019-0185 and WA-2019-0299.

<sup>11</sup> This was as of the date of this filing (December 21, 2022).

<sup>12</sup> Exhibit 10, Freeman Direct, page 5. Confluence Rivers has received Commission approval to acquire an additional five systems since this case was filed. See, Oasis Mobile Home Park (Case No. SA-2023-0187); Tan Tar A State Road, LLC (Case No. WA-2023-0003); Four Seasons North Mobile Home Park (Case No. WA-2023-0284); Lost Valley (Case No. SA-2023-0215); and Stone Ridge (Case No. WA-2023-0092). In addition, Confluence Rivers has seven pending applications to acquire the following systems: Brussels Valley Estates, Inc., Johnson Bay subdivision, and Mapaville Meadows (all contained in WA-2023-0450 / SA-2023-0451); Lake Sherwood (Case No. WA-2024-0048); Village of Luray (Case No. SA-2023-0437); Quail Run (Case No. WA-2023-0398); and Shelton Estates (Case No. SA-2021-0426).

wastewater system are reflective of the improvements that Confluence Rivers have made in Missouri. In fact, the results of the work of Confluence Rivers have been dramatic.

Indian Hills: In 2016, Confluence Rivers acquired the Indian Hills water system at the request of the PSC. Prior to that time, this neglected system, regulated by the Commission,<sup>13</sup> endangered the health of the community's approximately 2,500 residents.<sup>14</sup> Specifically, both well houses were in such a state of disrepair as to pose hazards to anyone required to enter them. They were infested with mold and mildew and lacked adequate ventilation. In fact, Well House 2 was in such bad shape that independent technicians were engaged to assess the facilities and they declared the structure inoperable. And the electrical system in Well House 1 – which housed the community's primary water source – was so deteriorated and neglected that anyone entering the structure risked electrocution. The drinking water systems at times had seventy percent water loss and, based on observations at the time of closing, did not meet Missouri Department of Natural Resources ("MDNR") minimum pressure to parts of the community for decades thereby putting residents at risk for pathogen exposure.<sup>15</sup> The water meters were built inside cardboard meter pits and were failing. The water taps were made out of flexible rubber pipes that were essentially glorified garden hoses. These and similar, substandard conditions caused MDNR to issue twenty-seven citations for violations of applicable safe drinking water laws.<sup>16</sup>

Upon acquisition, Confluence Rivers initiated a \$1.84 million upgrade of the Indian Hills water system. Among the improvements that were made were: (1) existing well houses were demolished and replaced with separate rooms for disinfection equipment; (2) piping was run from the well through the main well house where a magnetic meter and testing tap were installed; (3)

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<sup>13</sup> Exhibit 5, Cox Rebuttal, Schedule JMC-R-1/

<sup>14</sup> Exhibit 4, Cox Direct, page 11.

<sup>15</sup> Minimum pressure is necessary to keep outside elements from entering into the drinking water system.

<sup>16</sup> *Id.* at page 11.

pipng was then run into a separate disinfection room where chlorine is added via redundant pumping; (4) piping then fed into a new 270,000 gallon storage tank that allows for mandatory chlorine contact time; (5) piping then was run from the ground storage tank into the main building where a chlorine analyzer provided constant reading of residual disinfection; (6) water is then fed through dual variable frequency drive booster stations and forced into the water distribution system; (7) a backup generator was installed to meet MDNR requirements for system stability; (8) remote equipment monitoring for well production; chlorine addition and residuals; well pumping and status of the backup generator were installed; (9) the old non-functioning well was plugged to MDNR specifications; (10) a new 500 foot water well was drilled to MDNR requirements for source redundancy; and (11) 725 drinking water grade HDPE meter pits were installed with new remote electronic meters.<sup>17</sup>

The dramatic nature of the improvements at Indian Hills is shown in the attached video.<sup>18</sup>



Additionally, the following pictures show the condition of the storage tank and water lines at the time that the system was acquired by Confluence Rivers as well as pictures of the new 270,000-gallon storage tank, the upgraded disinfection, and booster pumps installed by Confluence Rivers.

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<sup>17</sup> *Id.* at pages 11-12.

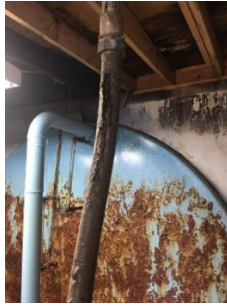
<sup>18</sup> Exhibit 6, Cox Surrebuttal, page 4 (footnote 3).



**AT TIME OF INDIAN HILLS ACQUISITION**



Indian Hills Storage Tank



Storage Tank



Water Line

**AFTER IMPROVEMENTS AT INDIAN HILLS**



New Storage Tank



New Disinfection



New Booster Pumps

Missouri Utilities: In 2018, Confluence Rivers purchased,<sup>19</sup> at the request of the MDNR, several water and wastewater systems, including the State Park Village and Shriners Golf Course systems operated by Missouri Utilities. Missouri Utilities, a Commission regulated company, had been in state appointed receivership for twelve years. The State Park Village wastewater system was discharging harmful contaminants including BOD5, TSS, ammonia and fecal coliform (E. Coli) into an adjoining Missouri state park creek tributary that was a headwater to a public access stream where Missouri State Park visitors could come into direct contact with human waste pathogens. At the Shriners community, raw sewage continually spilled on to the golf course. Additionally, rainwater collecting in the Shriners' sewage system caused basements to flood with

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<sup>19</sup> The acquisition was made through a Confluence Rivers predecessor called Elm Hills.

untreated sewage. Similarly, the Shriners drinking water system had failed causing a community-wide water outage that the residents had to proverbially “pass the hat around” to collect money to fix a well pump. This system had several inches of rust sludge inside the pressure tank and an exposed wellhead which means residents were ingesting rust sediment, and potential pathogens had the ability to enter the drinking water system exposing residents to human health risks.<sup>20</sup>

The distressed nature of the Missouri Utilities systems was expressly acknowledged by the Commission in its *Order Approving Stipulation and Agreement, Granting CCN and Transfer of Assets*.

Originally granted a CCN to provide water and sewer service in Case No. WA-92-291, MO Utilities has been in receivership since August 14, 2006. MO Utilities has received notice from the Missouri Department of Natural Resources (“DNR”) for exceeding permitted discharge limits, failure to maintain facilities, and failure to submit required reports. As Staff notes in Appendix A of its June 8, 2017 Recommendation, the current system is unable to meet anticipated new discharge limits for Escherichia coliform (E. Coli) bacteria and ammonia.<sup>21</sup>

Upon acquisition, Confluence Rivers initiated a \$1 million upgrade of these systems including converting the State Park Village wastewater plant to a state-of-the-art fixed film media plant with full ultraviolet disinfection system protecting state park visitors. At the Shriners Golf Community, CSWR used a biological process to remove sludge from the lagoons thereby restoring the system’s full capacity and preventing overflows as well as installing a new bioreactor and ultraviolet sanitation technology to remove E.coli. On the Shriners drinking water side, Confluence Rivers did a full tank restoration process, well remediation, and ran a water main to Sedalia to provide an emergency backup water source which ensured safe and reliable service.<sup>22</sup>

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<sup>20</sup> *Id.* at page 12.

<sup>21</sup> Exhibit 5, Cox Rebuttal, Schedule JMC-R-1.

<sup>22</sup> Exhibit 4, Cox Direct, page 13.

Again, the dramatic nature of the improvements made by Confluence Rivers is demonstrated in the attached video.<sup>23</sup>

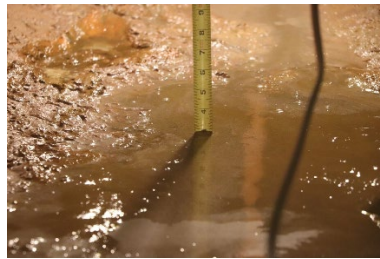


These improvements are also obvious from the following before and after pictures.

**AT TIME OF MISSOURI UTILITIES ACQUISITION**



Missouri Utilities Water Tank (Exterior)



Missouri Utilities Water Tank (Interior)

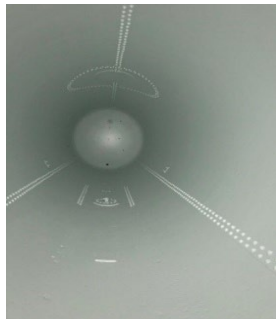


State Park – No Aeration or Railing

**AFTER IMPROVEMENTS AT MISSOURI UTILITIES**



Mo Utilities Tank (Exterior)



Missouri Utilities Tank (Interior)



State Park Village – Aeration and Railing

In fact, given its proven track record rehabilitating small, distressed water and wastewater systems, the Commission, and Missouri state courts, have recognized Confluence Rivers' abilities:

<sup>23</sup> Exhibit 6, Cox Surrebuttal, page 4 (footnote 3).

Osage Utility has the technical, managerial, and financial ability to provide safe and adequate service to the OWC service areas. Osage Utility provided a comprehensive plan for necessary improvements, which the Commission found reasonable. Given the inadequate service that has been provided to some of the OWC areas, the Commission gave particular weight to the stability that Osage Utility can provide to its customers after more than fourteen years of instability. The Commission found significant Osage Utility's affiliates' "proven track record of bringing distressed systems into compliance and operating them in a safe and adequate manner."<sup>24</sup>

The appreciation for the work performed by Confluence Rivers has not been limited just to the Commission or Missouri courts. Recently, the MDNR submitted a letter of support on behalf of Confluence Rivers.

When systems are unable to resolve their technical, managerial, or financial problems, one reliable solution is selling the system to a higher-performing utility operating company. **In Missouri, Confluence Rivers Utility Operating Company, Inc. (CRUOC) is one of the few utility operating companies who is willing to acquire some of the most difficult failing systems. CRUOC has consistently taken swift actions after taking control of these systems to bring them into compliance by employing qualified operators, effectively administering and managing the systems, and investing in repairs and upgrades.**

CRUOC's willingness to acquire systems with long-standing compliance issues has proven to be beneficial to human health and the environment by bringing many of these systems into compliance with environmental laws. The Department looks forward to continuing to work with CRUOC as it continues to acquire wastewater and public water systems in Missouri, in furtherance of the Department's initiative to encourage regionalization and consolidation of the many private systems in Missouri that are struggling to achieve compliance with laws for the protection of public health and the environment.<sup>25</sup>

Despite the past Commission assistance as well as the appreciation of MDNR, Staff and Public Counsel have taken positions that undermine Confluence Rivers' efforts. Specifically, as regards the treatment of: (1) income taxes; (2) acquisition-related costs; (3) cost of capital; and (4)

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<sup>24</sup> *In re: Osage Utility Operating Company, Inc.*, 637 S.W.3d 78, 97 (Mo.App. 2021). Osage Utility Operating Company is a predecessor company of Confluence Rivers.

<sup>25</sup> Exhibit 5, Cox Rebuttal, Schedule JMC-R-2 (emphasis added).

operations, maintenance, and oversight, the Staff and Public Counsel seem determined to hinder any further acquisition and rehabilitation of distressed systems.

**Income Taxes:** At the time that it acquires a distressed system, Confluence Rivers adopts the rates currently in effect for that system. In many cases, those rates are decades old.<sup>26</sup> Thus, rates do not reflect the cost of operation. As a result, until it completes a rate case, Confluence Rivers incurs a net operating loss associated with these systems. In past Staff-assisted rate cases, the Staff and Public Counsel have normalized taxes.<sup>27</sup> That is to say, they have included a level of income taxes that would be associated with Confluence Rivers' earnings resulting from those rates. With their positions in this case, however, Staff and Public Counsel have instituted a dramatic shift in the manner in which it handles Net Operating Losses. Specifically, Staff and Public Counsel no longer seek to normalize taxes. Rather, they now seek to utilize a flow-through method for calculating income taxes. As a result, Staff and Public Counsel utilize past Net Operating Losses absorbed by the shareholders to shield any income tax burden resulting from rates in this case. Therefore, Staff and Public Counsel have not included any income taxes in rates in its revenue requirement in this case.

As indicated, Staff and Public Counsel's position represents a radical change in how acquirers of distressed systems, including Confluence Rivers, have thought that income taxes would be calculated in Missouri. Effectively, Staff and Public Counsel have changed the "rules of the road" in this case. As Confluence Rivers has indicated, Staff and Public Counsel's position is dramatically different than in any of the other states in which CSWR operates. As such,

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<sup>26</sup> See, Exhibit 6, Cox Surrebuttal, page 13 ("For instance, the current Port Perry sewer rates are \$18.94 / month and have not changed since January 1, 1994.") (citing to Case No. SR-94-122).

<sup>27</sup> Even though these are Staff assisted rate cases, Staff produces EMS runs and workpapers from which the Company can determine the method by which Staff calculated revenue and expense items, including income taxes.

recognizing that there is limited capital to acquire and rehabilitate systems,<sup>28</sup> Staff and Public Counsel have placed Missouri at a significant disadvantage to other states as it applies to the attraction of capital to distressed systems.

**Acquisition-Related Costs:** As explained, *infra*, Confluence Rivers routinely incurs legal and engineering costs, both before and immediately subsequent to its acquisitions. The engineering costs are used to determine the need for capital improvements, system mapping, and initial assessment of the operation and capital requirements for bringing the plants into compliance. The legal costs are used to determine clean title to the property, confirming or acquiring proper easement access to the system components, and the costs to appropriately file required acquisition documentation with the Commission.

Consistent with the Uniform System of Accounts (“USOA”), Confluence Rivers books such legal and preliminary engineering costs to Account 183. While previously allowing the capitalization of such costs in previous rate cases, Staff suddenly disallowed those costs in this case under the premise that such costs were considered “transaction costs” and “are not used or useful nor necessary for the provision of safe and adequate service.” As reflected, *infra*, Staff did not make any attempt to determine whether the individual costs that it disallowed facilitated the provision of utility service or aided in the provision of safe and adequate service. The systems Confluence Rivers buys commonly lack system mapping, which prevents safe and reliable service and accurate (and, sometimes, any) asset lists, which preclude a company from being able to run a system.<sup>29</sup> The systems also commonly lack clear title, which means the utility is running

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<sup>28</sup> Tr. Volume 9, page 90.

<sup>29</sup> See Tr. Volume 9.5, pages 27, 41 (Cox).

components on property they don't own, and almost all the systems need additional easements to have lawful means of accessing assets to provide service.<sup>30</sup>

Again, Staff's position represents a radical change in direction in the manner in which it handles such cost for ratemaking purposes. Moreover, since no other state seeks to disallow these costs, Staff's position places Missouri at a significant disadvantage when it comes to the attraction of capital for the purposes of acquiring and rehabilitating distressed water systems.

**Cost of Capital:** In determining the return on equity, capital structure, debt cost and, ultimately, the rate of return for Confluence Rivers, the Commission must provide enough revenue not only for operating expenses but also for the capital costs of the business, which includes service on the debt and dividends on the stock. In doing so, the return to the equity should be commensurate with returns on investments in other enterprises having corresponding risks.<sup>31</sup>

It is the nature of the Company's business to take on small, distressed systems and bring those systems into regulatory compliance. There are practical limitations on rates as the Company adds systems, risk involved in the water and sewer industries in general, and risk associated with the distressed small systems' fundamental lack of size. These factors do not call for an average large water utility return on equity, as seems to be suggested by the Staff and the Public Counsel. It suggests a result that instead reflects "investments in other enterprises having corresponding risks."

Therefore, the appropriate return on common equity for a company the size of Confluence Rivers with the business risk associated with acquiring distressed systems and incurring net operating losses is 11.35%. The appropriate capital structure consists of 68.56% common equity and 31.44% long-term debt. This capital structure reflects the actual debt issuance authorized by

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<sup>30</sup> See Tr. Volume 9.5, pages 29, 42 (Cox).

<sup>31</sup> See *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

the Commission in December 2022. Confluence Rivers' appropriate cost of debt is 6.60%, which reflects the contractual debt cost.

**Operation, Maintenance, and Oversight:** Since it began operations in Missouri in 2014 Confluence Rivers has used third party contractors to perform operations and maintenance (“O&M”) services for its water and wastewater systems. For the first time in any of the Company’s numerous cases before this Commission—its numerous acquisition cases as well as its five prior staff-assisted rate cases—Public Counsel challenges that business plan, arguing that an in-house workforce of nine employees dispersed to an equal number of arbitrarily-drawn geographic districts can perform all required O&M functions and can do so at an annual cost of just \$600,000, representing an annual savings of approximately \$1 million.

But Public Counsel’s proposal is fundamentally flawed, as the evidence in this case clearly demonstrates. Because the witness sponsoring Public Counsel’s proposal lacks any training or work experience in the design, operation, or maintenance of water and wastewater systems he grossly underestimates the cost of labor to perform required O&M tasks, completely omits from his estimate the costs of vehicles, heavy equipment, spare parts, and storage facilities his cost savings estimates are illusory. Indeed, if O&M functions were moved in-house as Public Counsel proposes, instead of cost savings the cost of providing these services actually would increase by more than \$553,000 compared to the cost of third-party contractors included in the test year cost of service.<sup>32</sup> Public Counsel also ignores the fact that the Company currently has long-term O&M contracts, does not own any of the requisite equipment required to service the systems, or have any operations personnel hired.

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<sup>32</sup> Exhibit 6, Cox Surrebuttal, page 40.



If the Commission believes Confluence Rivers' use of third-party contractors warrants further study, Staff and the Company have a better idea. As part of their proposed non-unanimous stipulation, those parties propose a process to (1) formally study the costs and benefits of bringing O&M services in-house compared to the continued use of third-party contractors, (2) present the findings of that study to Staff and Public Counsel for their consideration and critique, and (3) updating the study prior to Confluence Rivers' next general rate case so that all parties and the Commission can consider O&M options available to the Company based on a full and complete record that evaluates and considers all relevant costs and qualitative factors.

## II. INCOME TAXES

Issue: With respect to income tax –

- a. How should income tax expense be set for purposes of establishing the revenue requirements?
- b. If the Commission allows Confluence to recover income tax expense in an amount greater than what would be remitted to the IRS in a given tax year, should the excess income tax expense be booked to a deferred liability account that will offset rate base?

### A. Introduction

When it acquires a distressed water or sewer system, Confluence Rivers typically adopts the rates currently charged to customers. This allows customers to realize benefits, in the form of more professional operations and customer service, prior to the customers experiencing a rate increase. The problem is, however, that the adopted rates are rarely adequate to cover operating costs. This is generally the result of two factors. ***First***, in many cases, the adopted rates have not changed in years, if not decades. “For instance, the current Port Perry sewer rates are \$18.94 / month and have not changed since January 1, 1994.”<sup>33</sup> Thus, the adopted rates do not cover any level of professional operating costs. ***Second***, in many cases, the operating costs used to set rates were based upon a diminished level of service which typically included failed assets. Specifically, because of owner neglect, in many cases aerators, blowers, and pumps have failed. As a result, the level of electrical costs in rates are deflated. Similarly, the previous owner will fail to apply any disinfection. Thus, the level of chemical costs included in rates is also deflated. At the time that it acquires the system, Confluence Rivers will immediately replace failed equipment and begin applying necessary disinfection. Therefore, electrical and chemical costs immediately increase. Additionally, Confluence Rivers will begin inspecting these systems on a regular basis as required by DNR regulations.<sup>34</sup> Therefore, third-party operations costs will increase. In any event, as a

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<sup>33</sup> Exhibit 6, Cox Surrebuttal, page 13 (citing to Case No. SR-94-122).

<sup>34</sup> See, 10 CSR 20 (drinking water) and 10 CSR 60 (wastewater).

result of the deflated rates and increased operating expense, Confluence Rivers always incurs a net operating loss upon acquired a distressed system.<sup>35</sup> In fact, between 2016 and 2021, Confluence Rivers incurred \$7.77 million in net operating losses.<sup>36</sup> Moreover, this net operating loss balance is expected to grow to \$9.77 million in 2022.<sup>37</sup>

An important point to remember, in considering the equities of this issue, is that shareholders alone bore the cost of these losses. Since ratepayers benefitted from paying inadequate rates, they did nothing to help cover these past losses.<sup>38</sup> Rather, the ratepayers were the root cause of the operating loss. So, while shareholders bore the cost, ratepayers were receiving the benefit. Now, after benefiting from these past net operating losses, Staff asserts that these same ratepayers should also receive the tax benefit of the net operating losses by using them to shield ratepayers from any income tax component in the revenue requirement in this case.

## **B. Change in Staff's Position**

Historically, Staff and Public Counsel have set rates for all regulated utilities on a normalized basis.<sup>39</sup> That is to say, Staff and Public Counsel have included in rates a normalized level of income taxes based upon the earnings<sup>40</sup> that result from the rates established by the Commission. In this way, rates are established (including a normalized level of income taxes) regardless of the utility's actual taxes in any particular year. Not only has Staff utilized tax

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<sup>35</sup> Exhibit 19, Thies Surrebuttal, pages 8-9. As Staff explains, a net operating loss results from a situation in which “a utility does not have enough taxable income to utilize all of the tax deductions to which it would otherwise be entitled.” (Exhibit 123, Bolin Surrebuttal, page 1). In this case, the tax deduction to which Confluence Rivers would otherwise be entitled to claim, if it had taxable income, is routine business expenses.

<sup>36</sup> Exhibit 123, Bolin Surrebuttal, page 3.

<sup>37</sup> *Id.*

<sup>38</sup> This stands in stark contrast to several states, including Louisiana and Mississippi, in which CSWR is allowed to book a regulatory asset for these losses and recover them in rates in subsequent rate cases. (Tr. Volume 9, page 66). Given this, acquisitions in those states would “be viewed more favorably than acquisitions in Missouri.” (Tr. Volume 9, page 68).

<sup>39</sup> Tr. Volume 9, pages 130-131.

<sup>40</sup> Earnings are calculated based upon the statutory tax rate multiplied by the return on equity multiplied by the equity portion of the capital structure.

normalization for all other Missouri utilities, it has also used tax normalization, without fail, for all previous Confluence Rivers rate case.<sup>41</sup>

Suddenly, in this case, Staff has radically changed direction.<sup>42</sup> Specifically, Staff contends that, as a result of the utilization of net operating losses, Confluence Rivers will not have to pay income taxes in the current period.<sup>43</sup> Therefore, Staff has not included income taxes in its proposed revenue requirement. Thus, while acknowledging that ratepayers have already received the benefit of past deflated rates that resulted in the net operating losses, Staff now asserts that ratepayers should also receive a second benefit by recognizing these net operating losses for purposes of establishing the level of income taxes to be included in rates. Putting aside the fundamental inequity associated with allowing ratepayers to benefit from the net operating losses after already benefitting from deflated rates, Staff's position has other major flaws.

The practical effects then of Staff's use of net operating losses for ratemaking purposes are threefold. ***First***, Staff's methodology serves to deny Confluence Rivers of a significant level of revenues.<sup>44</sup> After suffering for over 7 years from deflated revenues associated with inadequate rates, Staff suggests that Confluence Rivers suffer from further depleted revenues, due to the implications of net operating losses, another couple of years. Staff makes this recommendation even though Confluence Rivers is not even expected to begin recognizing such net operating losses for tax purposes for several years.

***Second***, Staff's position places Missouri at a major disadvantage when it comes to the attraction of limited capital for the purpose of acquiring and rehabilitating distressed water and

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<sup>41</sup> Tr. Volume 9, pages 129-130.

<sup>42</sup> Staff readily acknowledges, in questioning from Commissioner Holsman, that its decision to change methodologies in this case is "arbitrary". (Tr. 171-172).

<sup>43</sup> The recognition of actual income taxes in rates is known as flow-through ratemaking.

<sup>44</sup> Specifically, by using net operating losses to reduce income tax liability for ratemaking purposes, Staff has reduced rates by \$233,742 (based upon the net operating income resulting from Staff's revenue requirement). Exhibit 123, Bolin Surrebuttal, page 2.

wastewater utilities. It is well established that capital is very limited for purposes of acquiring and rehabilitating distressed water and wastewater systems. Staff's position, to utilize net operating losses for purposes of establishing rates long before they can be used for tax purposes, is dramatically different from the approach that is used for ratemaking purposes by any other CSWR jurisdiction.<sup>45</sup> As such, recognizing that capital will naturally be attracted to jurisdictions with the lowest level of risk and / or highest return on equity, this limited capital will be assigned to other jurisdictions long before it is deployed in Missouri. Therefore, Staff's position has the fundamental effect of ensuring that distressed Missouri systems remain distressed, and that Missourians are subjected to unsafe water and wastewater service long after customers in other states are provided this fundamental necessity.<sup>46</sup>

***Third.*** Staff's position, since it constitutes a radical change in position regarding its treatment of net operating losses, introduces a significant level of regulatory uncertainty to the Missouri ratemaking paradigm. As previously indicated, Staff readily acknowledges that, in all previous Confluence Rivers rate cases, it included a normalized level of income taxes in its recommended revenue requirement.<sup>47</sup> Unlike this case then, Staff, in those cases, ignored these net operating losses caused by customers and absorbed by shareholders. Instead, in those cases, Staff properly calculated rates based upon income taxes computed at the statutory tax rate on the earnings derived from rates. Based upon this recognized "rule of the road", Confluence Rivers perceived a level of regulatory certainty that allowed it to eventually acquire over 70 distressed water and wastewater systems. With its sudden change in direction, however, Staff has changed

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<sup>45</sup> Tr. Volume 9, pages 129-130.

<sup>46</sup> The implications of Staff's position should not be surprising. As Staff readily acknowledges, its positions are formulated without any regard to their effect on the bigger picture of the acquisition or rehabilitation of distressed systems or "how [Staff's positions] would impact future acquisitions." Tr. Volume 9, pages 125-126.

<sup>47</sup> Tr. Volume 9, pages 129-130.

the “rules of road” and introduced a heightened level of regulatory uncertainty. Again, this regulatory uncertainty introduces risk that necessarily dictates that limited capital will be first deployed to other jurisdictions.

**C. Staff’s Past Use of Tax Normalization Was Not A Component of Settlement**

At various points, it has been implied that Confluence Rivers has violated the terms of previous settlement documents by pointing out that Staff included a normalized level of income taxes in those previous cases. Implicit in this argument is the notion that Staff’s inclusion of a normalized level of income taxes in those previous Confluence Rivers rate case was a result of settlement. Such a suggestion is fundamentally wrong. As the record indicates, the inclusion of a normalized level of income taxes was part of Staff’s initial audit.<sup>48</sup> As such, since Staff’s position on this item matched the position advanced by the Company, it was not a subject of settlement. Rather, it was the point of agreement long before settlement occurred. Instead, as in any case, the terms of a settlement only concerned the items of differences between the Company and Staff.

**D. Staff And Others Routinely Use Normalization**

Recognizing the multitude of problems associated with its position, Staff claims that it is not legally obligated to normalize income taxes.<sup>49</sup> While Staff is correct (e.g., that it is not legally obligated to include tax normalization for ratemaking purposes), Staff’s position is 180° contrary to its typical ratemaking position. As Staff readily admits, it routinely uses “normalization” with regard to all other aspects of operating expense and revenues.<sup>50</sup> After voluntarily using

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<sup>48</sup> Tr. Volume 9, pages 129-130.

<sup>49</sup> Utilities that opt into accelerated depreciation are required to include a normalized, rather than a flow-through, level of income taxes. To date, given that accelerated depreciation would only lead to further losses, Confluence Rivers has not opted into accelerated depreciation. Exhibit 16, Seltzer Rebuttal, page 4.

<sup>50</sup> Exhibit 110, Majors Direct, page 5.

normalization for all other operating expense and revenue, Staff now suddenly retreats from this fundamental ratemaking position in favor of a flow through level of income taxes.

While the issue of tax normalization, for a utility that is not legally mandated to use tax normalization, has not been addressed in Missouri;<sup>51</sup> the issue has been addressed by the Federal Energy Regulatory Commission (“FERC”). Repeatedly, FERC has required utilization of tax normalization, even where not dictated by IRS normalization requirements associated with accelerated depreciation.

[A]fter careful analysis, in Order 144, FERC determined that proper normalization ratemaking should be extended to most book/tax timing differences, expressly including situations where, as here, expenses are recognized for book purposes prior to when they are properly deductible for tax purposes, a so-called Category 2 timing difference. Moreover, FERC, relying in part on *Memphis Gas, Light and Water Division v. F.P.C.*, 500 F.2d 798 (D.C. Cir, 1974), expressly held that the normalization policy it was adopting not only satisfied the “actual taxes” principle by recognizing both current and future tax liabilities, but also comported with “sound regulatory principles.”<sup>52</sup>

Ultimately, FERC’s mandate to utilize tax normalization for ratemaking purposes was promulgated in the Code of Federal Regulations. Specifically, 18 CFR § 35.24(b)(1) states:

(b) *General rules* —

(1) *Tax normalization required.*

(i) **A public utility must compute the income tax component of its cost of service by using tax normalization** for all transactions to which this section applies.<sup>53</sup>

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<sup>51</sup> As Ms. Bolin acknowledges, other Missouri utilities have other opted into accelerated depreciation and must, therefore, use a normalized level of income tax OR the other Missouri utilities all have taxable income. In this case, Confluence Rivers has neither opted into accelerated depreciation nor attained a level of taxable income.

<sup>52</sup> Exhibit 16, Seltzer Rebuttal, page 8 (citing to FERC 144). There is no question that the tax implications associated with a net operating loss is simply a “tax timing difference.” As the Missouri Court of Appeals has noted, “a company is allowed to deduct certain costs against income for tax purposes **at different times** than when it is allowed to reflect the same costs as a reduction to income for financial reporting purposes.” *Missouri-American Water Co. v. P.S.C.*, 591 S.W.3d 485 (Mo.App. 2019) (emphasis added). Similarly, Financial Accounting Standard 109, ¶11b recognizes that “expenses of losses that are deductible [for tax purposes] after they are recognized in financial income” is a temporary timing difference.

<sup>53</sup> 18 CFR §35.24(b)(a) (emphasis added).

Recognizing that normalization of taxes is: (1) consistent with Staff's wide-spread embrace of normalization; (2) is reflective of Staff's past handling of income taxes for all Missouri utilities including all previous Confluence Rivers rate cases; (3) complies with FERC declarations on the proper handling of income taxes for ratemaking purposes; and (4) would not place Missouri at a disadvantage relative to all other CSWR states that utilize tax normalization, Confluence Rivers urges the Commission to utilize tax normalization.



### III. ACQUISITION-RELATED COSTS

Issue: What legal and preliminary engineering costs related to acquisitions and applications for certificates of convenience and necessity should be capitalized?

Confluence Rivers acquires the assets of distressed water and sewer utilities throughout Missouri.<sup>54</sup> Sometimes Confluence Rivers is acquiring assets from existing water and/or sewer corporations, and many times it is acquiring systems that are either being run by non-regulated entities or entities that should have been regulated but have not submitted themselves to such.

In acquiring these assets, Confluence Rivers incurs certain costs both before and immediately subsequent to the acquisition that primarily arise from necessary legal and engineering expenditures directly related to the acquisitions. These costs include expenditures that allow the Company to determine the capital improvements that will need to be made to the system. They also include the legal and other costs associated with securing clean title to the property, confirming or acquiring proper easement access to the system components, and the costs to appropriately file required acquisition documentation with the Commission.<sup>55</sup> These expenditures also include engineering costs for system mapping and initial assessment of the operation and capital requirements for bringing the plants into compliance.<sup>56</sup>

Exhibit 221 provides Staff's analysis of the items incurred since October 1, 2019, which amounted to a total cost of \$987,852.00. These costs are almost entirely incurred for engineering and legal (both real estate and the regulatory approval process).<sup>57</sup> Staff's review summarized the costs since 2019 as follows:

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<sup>54</sup> Exhibit 18, Thies Rebuttal, page 10.

<sup>55</sup> *Id.*

<sup>56</sup> Exhibit 19, Thies Surrebuttal, page 8.

<sup>57</sup> Exhibit 221, page 4.

<b>Row Labels</b>	<b>Sum of Total</b>
Engineering-Survey	\$1,195
Engineering-Admin	\$208,525
Engineering-GIS	\$59,828
Engineering-Survey	\$165,158
Legal- Real Estate	\$430,667
Legal- Regulatory	\$114,272
(blank)	\$8,207
<b>Grand Total</b>	<b>\$987,852</b>

Consistent with the USOA, Confluence Rivers books such legal and preliminary engineering costs to Account 183 – Preliminary Survey and Investigation Charges:

This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc. made for the purpose of determining the feasibility of projects under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged.<sup>58</sup>

Recognizing that Account 183 holds Utility Plant expenditures, the balance in that account is capitalized and included in rate base.<sup>59</sup>

Staff seeks to disallow from the Company’s rate base \$1,218,969 of these types of costs (the costs since 2019, as well as the older costs remaining on the books). The impact of such a disallowance is two-fold – 1) it has a revenue requirement impact; and 2) it requires Confluence Rivers to write-off these prior investments.<sup>60</sup> Such a write-off has both tax implications and signals to the Company that such costs are not believed to be reasonable.<sup>61</sup>

Confluence Rivers believes this proposed disallowance represents a drastic shift in course for Staff. The costs are substantively similar to costs incurred by CSWR’s legacy utility operating companies, including Confluence Rivers, prior to the consolidation of those companies. The

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<sup>58</sup> *Id.* Exhibit 18, Thies Rebuttal, page 10.

<sup>59</sup> Tr. Volume 9.5, pages 18-19 (Thies).

<sup>60</sup> Tr. Volume 9.5, page 56 (Cox).

<sup>61</sup> *Id.*

Company was able to confirm by an examination of the workpapers Staff provided in the Staff-assisted rate cases filed by Confluence Rivers' predecessor companies Elm Hills (WR-2020-0275) and Confluence Rivers (WR-2020-0053) that these costs have previously been allowed and included with rate base. Furthermore, there were no disallowances of these costs in other rate cases filed by predecessor companies Hillcrest (WR-2016-0064), Raccoon Creek (SR-2016-0202) and Indian Hills (WR-2017-0259).<sup>62</sup> Staff witness Majors acknowledged that these types of costs had been included previously in rates.<sup>63</sup>

Staff labels these subject costs “transaction costs” and relies on two past Commission cases to disallow such costs:<sup>64</sup>

- *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc. for Approval of the Merger of Aquila, Inc. with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief*, Report and Order, Case No. EM-2007-0374 (Issued July 1, 2008) (“*KCPL/Aquila case*”); and,
- *In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & Power Company with and into UtiliCorp United Inc., and, in Connection Therewith, Certain Other Related Transactions*, Second Report and Order, Case No. EM-2000-292 (Issued February 26, 2004) (“*St. Joseph/UtiliCorp case*”).

These cases can be easily distinguished from the Confluence Rivers situation. Most obviously, both of these cases concerned large, operating, regulated electric corporations at the

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<sup>62</sup> *Id.* at page 12; See also Tr. 23 (Thies)

<sup>63</sup> Tr. Volume 9.5, page 74 (Majors).

<sup>64</sup> Exhibit 129, Majors Surrebuttal, pages 4, 7.

time of the proposed mergers.<sup>65</sup> Those mergers bear no resemblance to the types of small, distressed water and sewer systems acquired by Confluence Rivers.

Further, the quote Staff witness Majors uses from the *St. Joseph/UtiliCorp* case includes the following:

The net original cost rule was developed in order to protect ratepayers from having to pay higher rates simply because ownership of utility plant has changed, without any actual change in the usefulness of the plant.<sup>66</sup>

In “almost every,” if not “every,” Confluence Rivers acquisition the usefulness of the plant to be acquired is in question at the time of acquisition.<sup>67</sup> This is especially true where the existing systems are in a receivership or saddled with MDNR violations.<sup>68</sup>

Staff witness Majors suggests that “any costs related to the filing of an acquisition case before the Commission are owner’s costs as there is no benefit to ratepayers for these costs and these costs are not required for utility service.”<sup>69</sup> Of course, Staff’s frame of reference are cases under Section 393.190, RSMo, such as the *St. Joseph/UtiliCorp* case and *KCPL/Aquila* case cited by Staff.

Many of the cases by which Confluence Rivers has added systems don’t proceed under Section 393.190, RSMo because the existing system is either a type of system not regulated by the Commission, or it is a system that arguably should be regulated but has ignored Commission regulation.<sup>70</sup> In those instances, Confluence Rivers obtains a new certificate of convenience and

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<sup>65</sup> Tr. Volume 9.5, page 75 (Majors).

<sup>66</sup> Exhibit 129, Majors Surrebuttal, page 7 (emphasis added).

<sup>67</sup> Tr. Volume 9.5, page 76 (Majors).

<sup>68</sup> *Id.*

<sup>69</sup> Exhibit 129, Majors Surrebuttal, page 5.

<sup>70</sup> Tr. Volume 9.5, pages 77-78 (Majors).

necessity (CCN) pursuant to Section 393.170, RSMo.<sup>71</sup> Certainly, in those cases, the grant of a CCN is “required for [the provision of] utility service.”<sup>72</sup>

Staff specifically cites to the definitions of transaction and transition costs used in the *KCPL/Aquila case*.<sup>73</sup> The definition of transaction costs includes the statement that they are “not to facilitate the provision of utility service.”<sup>74</sup> The definition also states that transaction costs “are not used or useful nor necessary for the provision of safe and adequate service.”<sup>75</sup>

The systems acquired by Confluence Rivers were in significant states of disrepair due to significant deferred maintenance, improper operations and depreciated assets that were not properly replaced or even catalogued or mapped. Therefore, some of the preliminary expenditures that Confluence Rivers incurred were intended to determine the extent and scope of the condition of the systems and the needed repairs. The expenditures also included costs to determine proper title and sufficient easement and right of way access to properties or to obtain Commission approval of the transaction. These costs are a necessary component of operations in the present and the future.<sup>76</sup>

The steps necessary for Confluence Rivers to acquire the assets of small, distressed water and sewer utilities ultimately facilitate the provision of utility service and aid in the provision of safe and adequate service as to those systems. Staff witness Majors agreed with this premise:

I think as a general premise yes, the transfer of ownership prior to the acquisition -  
- prior to the acquisition and post acquisition there is an improved, definite  
improvement in safe and adequate service. No question.<sup>77</sup>

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<sup>71</sup> Tr. Volume 9.5, page 78 (Majors).

<sup>72</sup> *Id.*

<sup>73</sup> Exhibit 129, Majors Surrebuttal, page 6.

<sup>74</sup> *Id.* (emphasis added).

<sup>75</sup> *Id.* (emphasis added).

<sup>76</sup> Exhibit 18, Thies Rebuttal, pages 11-12.

<sup>77</sup> Tr. Volume 9.5, page 79 (Majors).

Staff did not make any attempt to determine whether the individual costs that it disallowed facilitated the provision of utility service or aided in the provision of safe and adequate service.<sup>78</sup> Staff merely relied on the fact that the Commission has routinely denied certain costs as a result of the St. Joseph and Aquila merger cases Mr. Majors cited.<sup>79</sup>

Given that Confluence Rivers' costs at issue are recorded and capitalized consistent with the USOA, and the resulting capital and operational improvements to these systems cannot occur without incurring such costs, the Commission should reject Staff's proposed disallowance.

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<sup>78</sup> Tr. Volume 9.5, pages 79-80 (Majors).

<sup>79</sup> Tr. Volume 9.5, page 80 (Majors).

#### IV. TIMESHEETS

Issue: Should the Commission order Confluence to require its employees, including executives, to keep timesheets that show the activities performed and where they were performed?

In accordance with disposition agreements executed in two Staff-assisted rate cases – Case Nos. WR-2020-0053 and WR-2020-0275 – the Company developed and implemented a computer-based time reporting system to track work CSWR’s employees performed on behalf of Confluence Rivers. Although those stipulations only required time records be kept for work performed for two pre-merger Missouri affiliates<sup>80</sup> – Elm Hills Utility Operating Company and Confluence Rivers Utility Operating Company – CSWR deployed a more robust system that records time for work its employees perform for each of the company’s utility affiliates, including those operating outside Missouri. In addition, as noted by Staff’s witness Ashley Sarver, employees have the ability to record time to an option called “All Companies” to reflect time spent on all CSWR systems.<sup>81</sup>

Prospectively, Staff recommends the Commission require all CSWR employees to keep daily timesheets that identify: (1) the affiliate for which work was performed and (2) which of the seven (7) function/task categories the work applies.<sup>82</sup> In addition, rather than recording time to “Confluence Rivers”, Staff would require CSWR to create additional subcategories to identify the individual system or tariff district for which work was performed.<sup>83</sup>

Confluence Rivers opposes Staff’s proposals. Staff’s recommendation that ALL CSWR employees be required to keep daily timesheets should be rejected because it imposes a burden with no corresponding benefit. And for reasons more fully explained later in this section, creating

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<sup>80</sup> In its October 14, 2021, Order in Case No. WM-2021-0412, the Commission authorized five of CSWR’s Missouri affiliates—Hillcrest Utility Operating Company, Elm Hills Utility Operating Company, Osage Utility Operating Company, Raccoon Creek Utility Operating Company, and Indian Hills Utility Operating Company—to merge into Confluence Rivers. The merger was completed effective January 1, 2022.

<sup>81</sup> Exhibit 107, Sarver Direct, page 19.

<sup>82</sup> The seven (7) function/task categories available in CSWR’s timekeeping system are business operations, rate cases, acquisitions, engineering, construction management, regulatory, and utility operations. *Id.*

<sup>83</sup> *Id.* at page 20.

additional timekeeping categories to record and capture time - and associated costs - on an individual system or tariff district basis would serve no useful future purpose if the Commission accepts certain of the agreements, including the consolidation agreement, reached by the parties as reflected in stipulations filed in the case.

In his surrebuttal testimony, Company witness Brent Thies explained why Staff's proposal that ALL CSWR employees be required to keep daily timesheets makes little sense:

The executive and director level of employees of CSWR are involved in setting procedures, monitoring operations performance, supervising employees and contractors and setting strategic direction for [CSWR]. A significant portion of their time is spent discussing these items at a level that impacts all customers of CSWR's subsidiaries and not just those in one individual entity or another. One example of this is the time spent by executives and directors in managing their staff teams, which would include monitoring employee development, holding departmental meetings, and directing staff in the management and supervision of vendor relationships. This portion of time spent managing at a level which affects all subsidiaries, and all customers, is time and compensation expense that should be allocated based on [CSWR's] three-factor overhead allocation methodology.<sup>84</sup>

Staff argues that it is necessary for all employees to keep daily timesheets because "Staff reviews the timesheets to determine what activities are performed by employees and in which state these activities occur, in order to include an accurate and appropriate amount of employee related expenses in Confluence Rivers cost of service."<sup>85</sup> However, under scrutiny Staff's argument is shown to be without merit because the need to allocate a significant amount of CSWR's executives' time, using the Company's three-factor overhead allocation method, would not change whether those senior leaders keep timesheets or use some other time reporting methodology.

Under Confluence River's timekeeping system, employees have the ability to record time to seventeen different operating companies or to an option called "All Companies," which is a category created to capture work performed by an employee that applies to all of CSWR's utility

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<sup>84</sup> Exhibit 18, Thies Rebuttal, page 19.

<sup>85</sup> Exhibit 131, Sarver Rebuttal, page 2.



operating subsidiaries.<sup>86</sup> Staff acknowledges that during its audit it observed “CSWR is beginning to record more and more time to ‘All Companies.’”<sup>87</sup> But that is to be expected of a company that as recently as mid-2019 served fewer than 4,000 customers in two states and now serves more than 146,000 connections in eleven states, because as CSWR has grown so has the scope of responsibility of its executives. No longer are they able to devote large amounts of time to a single state. Instead, their primary focus is on the entity as a whole and to reflect that fact they record more and more of their time to “All Companies.” Because those costs do not relate to a specific affiliate, they must be allocated using a general allocator, such as the three-factor allocator described in CSWR’s Cost Allocation Manual.<sup>88</sup>

Because time charged to “All Companies” already must be allocated and because CSWR’s executives are required to devote an ever-increasing amount of time to activities affecting all CSWR’s utility subsidiaries, imposing on these executives an obligation to keep timesheets creates a burden with no corresponding benefit. Therefore, the Company is proposing that prospectively, all employees at the director level and above be free of the obligation to maintain timesheets. Instead, time and benefits for such executives would be allocated to the various state utility operating companies based upon the general allocator.

In the alternative, Confluence Rivers requests that executives be allowed to do “Project Time-Tracking” instead of daily timesheets. Under this proposal, work time and associated compensation for these executives would be presumed to be general in nature and would be assigned using an allocation factor. However, these executives would identify and track time on a

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<sup>86</sup> At page 19 of her Direct Testimony (Exhibit 107), Ms. Sarver states employees have the option of charging time to “one (1) of twenty-three different utility operating companies.” That statement is in error because CSWR only has 17 utility operating company affiliates.

<sup>87</sup> Exhibit 107, Sarver Direct, page 20.

<sup>88</sup> A description of the three-factor allocator can be found in Mr. Thies Direct Testimony (Exhibit 17) at page 12.

monthly basis for special projects that pertain to a single or small subset of CSWR's affiliates. These projects might include annual audits, the rate cases of individual entities, large construction projects, certain company initiatives including software implementations or vendor selection processes and similar activities.<sup>89</sup> Such a system of exception timekeeping would accomplish the same objective as daily timesheets - i.e., identifying and capturing time spent on projects that directly benefit a particular affiliate - while freeing executives the burden of keeping timesheets on which a majority of their time would be coded to the "All Companies" category.

The Company's proposal to exempt its executives from the burdens of daily time reporting appears to be analogous to the system the Commission uses to apportion its annual expenses among Missouri utilities. That methodology was described as follows in the Commission's 2023 assessment order:

The Commission allocates to each utility group its directly attributable estimated expenses. Additional common, administrative and other costs not directly attributable to any particular group are assessed according to the group's proportion of the total gross intrastate operating revenue of all utilities groups.<sup>90</sup>

During the hearing in this case, Commissioner Hahn noted that while the Commission Staff keeps records documenting time spent on each utility group and project the commissioners themselves are exempt from such timekeeping.<sup>91</sup> Instead, because their responsibilities and focus extends to all Missouri jurisdictional utilities and are not "directly attributable to any particular group," commissioner-related costs are apportioned using an allocation factor. If such a system works well for the Commission, there is no reason to believe the Project Time-Tracking system Confluence Rivers is proposing won't work equally well.

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<sup>89</sup> Exhibit 18, Thies rebuttal, page 19.

<sup>90</sup> Case No. AO-2022-0346, *Assessment Order for Fiscal Year 2023* (June 15, 2022) at page 2.

<sup>91</sup> Tr. Volume 9.5, page 146.

In addition, rather than recording time to “Confluence Rivers” Staff proposes to require CSWR to create additional subcategories to identify the individual system or tariff district for which work was performed. The Company believes Staff’s proposal should be rejected for at least two reasons. First, insofar as Staff would require time to be recorded to a specific Missouri system or tariff district, the Company already maintains plant accounting records in a manner that requires water or wastewater plant investment to be booked to the specific system to which an investment applies. And while non-capitalized operating expenses are booked at the level of the state utility operating company for which the expense was specifically incurred - i.e., the Confluence Rivers level in Missouri - identifying such costs at a system- or tariff district-specific level would not be necessary if the Commission accepts the rate design/rate consolidation proposal advanced by Staff and the Company as part of their non-unanimous stipulation in this case. Under that proposal, rates for customers within Confluence Rivers’ service area would be consolidated statewide based on technology and infrastructure. If current tariff districts are eliminated there no longer would be any need for the Company to record expenses on a tariff district-specific basis. However, as part of their stipulation, the parties agree that operating costs would be maintained on a system-specific basis to allow development of a rate design that reflects the costs of all systems that utilize the same or similar technology and infrastructure.

## V. COST OF CAPITAL

Issue: With respect to cost of capital—

- a. What is the appropriate capital structure to use in calculating the Company's rate of return?
- b. What is the appropriate cost of debt to use in calculating the Company's rate of return?
- c. What is the appropriate return on common equity to use in calculating the Company's rate of return?

### A. Introduction

An appropriate ratemaking capital structure for Confluence Rivers consists of 31.44% long-term debt at a cost rate of 6.60% and 68.56% common equity at a return on common equity of 11.35%.<sup>92</sup>

#### 1. **Standard**

In *Bluefield Water Works & Imp. Co. v. Public Service Commission*, the United States Supreme Court summarized the Commission's duty as to this issue as follows:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightening judgment, having regard to all relevant facts.<sup>93</sup>

Missouri court decisions also recognize that the Commission has flexibility in fixing the rate of return, subject to existing economic conditions.<sup>94</sup>

The United States Supreme Court has described the question for the Commission as follows:

The rate-making process under the Act, i. e., the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. Thus we stated in the *Natural Gas Pipeline Co.* case that "regulation does not insure that the business shall produce net revenues." But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends

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<sup>92</sup> Exhibit 9, D'Ascendis Surrebuttal, page 1.

<sup>93</sup> *Bluefield Water Works & Imp. Co. v. Public Service Commission*, 262 U.S. 679, 692-3 (1923).

<sup>94</sup> *State ex rel. Laclede Gas Co. v. Public Service Commission*, 535 S.W.2d 561, 570-571 (Mo. App. 1976).

on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.<sup>95</sup>

The Commission itself has described its duty as follows:

In determining the rate of return, the Commission must consider Spire Missouri's capital structure and cost of debt, the Commission must determine the weighted cost of each component of the utility's capital structure. One component at issue in this case is the estimated cost of common equity capital, or the ROE. Estimating the cost of common equity capital is a difficult task, as academic commentators have recognized. Determining a rate of ROE is imprecise and involves balancing a utility's need to compensate investors against its need to keep prices low for consumers.<sup>96</sup>

The Commission is determining a return on equity for Confluence Rivers, not CSWR.

Consistent with the stand-alone ratemaking principle, it is reasonable and appropriate to consider the small size for Confluence Rivers relative to the companies with which it is being compared.<sup>97</sup>

As the Commission examines these issues for the purpose of exercising its "fair and enlightening judgment," it should keep in mind the nature of the Company's business to take on small, distressed systems and bring those systems into regulatory compliance, the practical limitations on rates as the Company adds systems, the risk involved in the water and sewer industries in general, and the Company's fundamental lack of size.

## **2. Confluence Rivers' Witness**

Confluence Rivers provided the testimony of Dylan W. D'Ascendis as to cost of capital. Mr. D'Ascendis is employed by ScottMadden, Inc., as a Partner. He has offered expert testimony on behalf of investor-owned utilities in over 35 state regulatory commissions in the United States,

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<sup>95</sup> *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (citation omitted) (emphasis added).

<sup>96</sup> *In the Matter of Spire Missouri Inc. 's d/b/a Spire Request for Authority to Implement a General Rate Increase for Natural Gas Service Provided in the Company's Missouri Service Areas*, Amended Report and Order, p. 95 (Issued November 12, 2021).

<sup>97</sup> Exhibit 9, D'Ascendis Surrebuttal, page 4, 15.

the FERC, the Alberta Utility Commission, one American Arbitration Association panel, and the Superior Court of Rhode Island on issues including, but not limited to, common equity cost rate, rate of return, valuation, capital structure, class cost of service, and rate design.

On behalf of the American Gas Association (AGA), Mr. D'Ascendis calculates the AGA Gas Index, which serves as the benchmark against which the performance of the American Gas Index Fund (AGIF) is measured on a monthly basis. He is a member of the Society of Utility and Regulatory Financial Analysts (SURFA) and was awarded the professional designation "Certified Rate of Return Analyst" by SURFA, which is based on education, experience, and the successful completion of a comprehensive written examination.

Mr. D'Ascendis is also a member of the National Association of Certified Valuation Analysts (NACVA) and was awarded the professional designation "Certified Valuation Analyst" by the NACVA in 2015. He has a Bachelor of Arts degree in Economic History from the University of Pennsylvania and a Master of Business Administration from Rutgers University.<sup>98</sup>

## **B. Return on Common Equity**

### **What is the appropriate return on common equity to use in calculating the Company's rate of return?**

#### **1. Confluence Rivers**

The appropriate return on common equity for a company the size of Confluence Rivers with the business risk associated with acquiring distressed systems is 11.35%.

Mr. D'Ascendis used three cost of common equity models, specifically the Discounted Cash Flow (DCF) model, the Risk Premium Model (RPM), and the Capital Asset Pricing Model (CAPM). These models were applied to the market data of a proxy group of six water companies (Utility Proxy Group). Additionally, he applied the DCF, RPM, and CAPM to a proxy group of

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<sup>98</sup> Exhibit 7, D'Ascendis Direct, pages 1-2.

domestic, non-price regulated companies comparable in total risk to the Utility Proxy Group (Non-Price Regulated Proxy Group).<sup>99</sup>

After analyzing the indicated common equity cost rates derived through these models, the indicated range of common equity cost rates applicable to the Utility Proxy Group is between 10.36% and 11.36% (the indicated range is equal to 50 basis points above and below the midpoint of the four model results).<sup>100</sup> Mr. D'Ascendis then made an upward adjustment for business risk (1.00%) and a downward adjustment for financial risk related to the amount of equity in the capital structure (0.51%), as relative to the Utility Proxy Group.<sup>101</sup> These adjustments result in a Company-specific range of common equity cost rates between 10.85% and 11.85%. A common equity cost rate of 11.35% is the approximate midpoint.<sup>102</sup>

It was generally agreed that the “average” water utility return on equity (ROE) awarded in 2022 and, so far, in 2023, for large water utilities, is approximately 9.6%.<sup>103</sup> This is largely based on an RRA Regulatory Focus report for 2022 and a second such report for 2023.<sup>104</sup> The Commission has sometimes recognized a zone of reasonableness using the national average of recent ROE awards (plus or minus 100 basis points) as a check on the Commission’s ROE.<sup>105</sup>

The “zone of reasonableness” is set on traditional water companies. Where you are addressing a utility such as Confluence Rivers, which is recognized as riskier than the traditional water company, any adder for that riskiness that is deemed appropriate, should be on top of the

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<sup>99</sup> Exhibit 7, D'Ascendis Direct, pages 3-4.

<sup>100</sup> *Id.* at page 4.

<sup>101</sup> *Id.* at page 5.

<sup>102</sup> *Id.*

<sup>103</sup> Tr. Volume 10, pages 135-136 (Murray).

<sup>104</sup> Exhibits 236 and 237 (Note that while the 2023 information arrives at a 9.40% average rate award, that calculation includes the 8.70% “outlier” awarded to Aquarion Water Co. of Connecticut (*See* Tr. 132 (Murray)). Without that outlier, the average for 2023 would be 9.58%).

<sup>105</sup> *In the Matter of Spire Missouri Inc.'s d/b/a Spire Request for Authority to Implement a General Rate Increase for Natural Gas Service Provided in the Company's Missouri Service Areas*, Amended Report and Order, p. 95 (Issued November 12, 2021).

range. Accordingly, it would not be unreasonable to award a ROE outside the zone of reasonableness.<sup>106</sup>

If the Commission were to reference such a range, it is worth noting that the low end of Mr. D'Ascendis' indicated range of common equity cost rates applicable to the Utility Proxy Group (10.36% and 11.36%), before he adds an adjustment for business risk, fits within that zone of reasonableness. That low end, with the addition of the upward adjustment for business risk (1.00%), as relative to the Utility Proxy Group, brings you back very close to the 11.35% recommendation.

## **2. Public Counsel and Staff**

Staff and Public Counsel take the position that Confluence Rivers, with its fewer than 10,000 connections (at the time of filing) spread between approximately 70 small water and sewer systems is worthy of a much lower ROE – one that would represent a mere “average,” or, in the case of Staff, below average, return on equity for a large water utility.

Public Counsel witness Murray describes a “fair and reasonable” allowed ROE range from 9.25% to 9.90%.<sup>107</sup> However, instead of working from this range, he starts his calculations with his 9.00% ROE “recommendation,” from the last Missouri-American Water Company (MAWC) general rate case (Case No. WR-2022-0303), based on his range in that case of 8.60% to 9.25%.<sup>108</sup> Case No. WR-2022-0303 (MAWC) was settled without Commission decision as to ROE. However, it is relevant to note for comparison that in the MAWC case (Case No. WR-2022-0303),

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<sup>106</sup> Tr. Volume 10, pages 39-41 (D'Ascendis).

<sup>107</sup> Exhibit 209, Murray Direct, page 44.

<sup>108</sup> Exhibit 209, Murray Direct, page 22.



Staff recommended an ROE for MAWC of 9.73%<sup>109</sup> and the MAWC recommendation was 10.5%.<sup>110</sup>

Mr. Murray does recognize that because the Confluence Rivers “systems rely on bank financing rather than direct access debt capital markets” and that “[t]his practical matter regarding access to capital along with some uncertainty related to financial performance of the acquired systems, justifies a 65 basis point upward adjustment.”<sup>111</sup> After adding this upwards adjustment for lack of access to capital and financial performance uncertainty to his MAWC ROE recommendation of 9.00%, Mr. Murray arrives at a recommendation of 9.65%

Staff witness Walters identifies a current “fair market range” for Confluence Rivers in the 9.2% to 9.8% range and uses its mid-point of 9.50% as his recommendation.<sup>112</sup> Unlike Mr. Murray and Mr. D’Ascendis, Mr. Walters makes no adjustment related to Confluence Rivers’ small size, limited access to capital, or financial uncertainty related to the types of properties acquired and rehabilitated by Confluence Rivers. This is in spite of the fact that neither he, nor Public Counsel witness Murray are aware of any other utility that is exclusively acquiring small, distressed systems.<sup>113</sup> The result, interestingly, is that Staff recommends a lower ROE for Confluence Rivers (9.50%) than it recommended for MAWC (9.73%) in the rate case referenced by Mr. Murray (Case No. WR-2022-0303). Mr. Walters provides no explanation as to why Staff recommended an ROE for Confluence Rivers that is 23 basis points less than that Staff recommended for MAWC.

After his lack of access to capital/financial uncertainty adjustment, Public Counsel witness Murray’s 9.65% recommendation is very near the 9.60% average of ROE’s granted for large water

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<sup>109</sup> Case No. WR-2022-0303, Jennings Direct, EFIS Item 68, pages 4, 36.

<sup>110</sup> Case No. WR-2022-0303, Bulkley Direct, EFIS Item 15, pages 7-8.

<sup>111</sup> Exhibit 209, Murray Direct, page 22 (emphasis added).

<sup>112</sup> Exhibit 109, Walters Direct, page 3.

<sup>113</sup> Tr. Volume 10, page 115 (Walters), page 137 (Murray).

utilities around the country in 2022 and 2023. Staff’s recommended ROE of 9.50% is less than that large water utility average.

### 3. Conclusion

Even a casual observer will recognize that Confluence Rivers is not like an “average” large water utility. Mr. Murray admitted as follows:

. . . I recognize the fact these systems rely on bank financing rather than direct access to debt capital markets. This practical matter regarding access to capital along with some uncertainty related to future financial performance of the acquired systems, justifies a 65 basis point upward adjustment.<sup>114</sup>

Staff witness Walters made no similar adjustment.

Mr. D’Ascendis recognized that Confluence Rivers is “different” through his Business Risk Adjustment.”<sup>115</sup> This adjustment for risk includes the following explanations:

Confluence Rivers’ smaller size relative to the Utility Proxy Group companies indicates greater relative business risk for the Company because, all else being equal, size has a material bearing on risk. Size affects business risk because smaller companies generally are less able to cope with significant events that affect sales, revenues, and earnings. For example, smaller companies face more risk exposure to business cycles and economic conditions, both nationally and locally.

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Also, it is a basic financial principle that the use of funds invested, and not the source of funds, is what gives rise to the risk of any investment.

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Consistent with the financial principle of risk and return discussed above, increased relative risk due to small size must be considered in the allowed rate of return on common equity. Therefore, the Commission’s authorization of a cost rate of common equity in this proceeding must appropriately reflect the unique risks of Confluence Rivers, including its small size, which is justified and supported above by evidence in the financial literature.<sup>116</sup>

Confluence Rivers’ market capitalization was at \$38.085 million as of October 31, 2022, compared with the median market capitalization of Mr. D’Ascendis’ Utility Proxy Group of \$3.34

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<sup>114</sup> Exhibit 209, Murray Direct, page 22.

<sup>115</sup> Exhibit 7, D’Ascendis Direct, pages 49-52.

<sup>116</sup> *Id.*

billion as of October 31, 2022. The Utility Proxy Group's market capitalization is 87.6 times the size of Confluence Rivers.<sup>117</sup>

The size and nature of Confluence Rivers' business justifies a ROE well above the average, or below average, large water utility ROEs recommended by Public Counsel and Staff. In fact, the difference is so profound that Staff and Public Counsel have proposed flow through taxes because of the presence of long-term operating losses incurred by Confluence Rivers buying small distressed utilities. Accordingly, the Commission should utilize an ROE of 11.35%, as recommended by Mr. D'Ascendis.

### **C. Capital Structure**

#### **What is the appropriate capital structure to use in calculating the Company's rate of return?**

##### **1. Confluence Rivers**

The appropriate capital structure is Confluence Rivers' actual capital structure of 68.56% common equity and 31.44% long term debt,<sup>118</sup> which includes the actual debt issuance with CoBank authorized by the Commission in December 2022. Common equity and long-term debt are commonly considered in establishing a utility's capital structure because they are the typical sources of capital financing a utility's rate base.<sup>119</sup>

Although the general objective is to extend the average life of long-term debt, long-term debt still has a finite life, which is likely to be less than the life of the assets included in rate base. Common equity, on the other hand, is outstanding into perpetuity. Thus, common equity more accurately matches the life of the going concern of the utility, which is also assumed to operate in

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<sup>117</sup> Exhibit 7, D'Ascendis Direct, pages 51.

<sup>118</sup> Exhibit 7, D'Ascendis Direct, page 15.

<sup>119</sup> *Id.*

perpetuity. Consequently, it is both typical and important for utilities to have significant proportions of common equity in their capital structures.<sup>120</sup>

In order to provide safe, reliable, and affordable service to its customers, Confluence Rivers must meet the needs, and serve the interests, of its various stakeholders, including customers, shareholders, and bondholders. The interests of these stakeholder groups are aligned with maintaining a healthy balance sheet, strong credit ratings, and a supportive regulatory environment, so that the Company has access to capital on reasonable terms in order to make necessary investments.<sup>121</sup>

Confluence Rivers' actual capital structure reflects its current circumstances. Confluence Rivers' current rates do not provide for the free cash flow needed for it to pay operating expenses and to cover the interest cost on any additional debt. In fact, Confluence Rivers is currently making no principal payments on the existing debt through agreement with CoBank, pending the outcome of this case.<sup>122</sup> Confluence Rivers currently does not have enough cash flow to pay both interest and principal on its existing loan.<sup>123</sup> In the event that additional cash flow is generated in the future, Confluence Rivers will seek to issue additional debt. But that day is not today and was certainly not the case as of the update period in this case.

## **2. Staff and Public Counsel**

Both Staff and Public Counsel seek to ignore the actual capital structure and utilize hypothetical capital structures. Public Counsel recommends the use of a capital structure

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<sup>120</sup> *Id.* at page 16.

<sup>121</sup> *Id.*

<sup>122</sup> Tr. Volume 10, pages 72-73 (Thies).

<sup>123</sup> Tr. Volume 10, page 73 (Thies).

consisting of 45% equity and 55% long term debt.<sup>124</sup> Staff recommends use of a capital structure consisting of 50% equity and 50% long term debt.<sup>125</sup>

Public Counsel picks its hypothetical capital structure because that is the minimum equity that Confluence Rivers could have under its existing debt covenants with CoBank.<sup>126</sup> This, of course, does not mean that CoBank would loan Confluence Rivers the amount of money necessary to result in a 55% long term debt percentage, nor does it mean that Confluence Rivers could cover the interest and principal payments on such loans, as discussed above.

Confluence Rivers witness Thies discussed an additional debt covenant found in the agreement with CoBank. That is, the requirement that at the end of the year Confluence Rivers will not have total debt that exceeds six (6) times its EBITDA (defined as “operating revenues minus operating expenses, plus depreciation and amortization expenses and non-cash expenses for Holding Company management fees”).<sup>127</sup> Regardless of the total debt percentage, that requirement indicates a pre-rate case total debt capacity limit of \$5,840,028.<sup>128</sup>

Confluence Rivers was able to borrow slightly more than \$7 million based on the authority granted by the Commission:

Confluence’s application requesting authority to issue long-term debt to CoBank in an amount not to exceed \$7.2 million, and to secure the long-term indebtedness by granting CoBank a lien on all equity Confluence owns now, and will own in the future, as well as a perfected priority lien on, and security interest in, all real and personal, tangible and intangible, present and future assets of Confluence, is granted.<sup>129</sup>

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<sup>124</sup> Exhibit 209, Murray Direct, page 4.

<sup>125</sup> Exhibit 109, Walters Direct, page 25.

<sup>126</sup> *Id.*

<sup>127</sup> Exhibit 209, Murray Direct, Sched. DM-D-3 C, page 11.

<sup>128</sup> Exhibit 18, Thies Rebuttal, page 31.

<sup>129</sup> *In the Matter of the Application of Confluence Rivers Utility Operating Company, Inc., for Authority to Issue Long-Term Debt and to Secure Same with a Lien on its Properties*, Order Correcting Order Granting Financing Application, p. 2, Case No. WF-2023-0023 (Issued December 14, 2022).

Reaching the 55% debt level proposed by Public Counsel, or even the 50% debt level proposed by Staff, would have required Confluence Rivers to borrow a significant amount more than the \$7 million, something that was not, and today is not, supported by its EBITDA.

As to the 45/55 covenant,<sup>130</sup> it was pointed out that assuming a capital structure with the bare minimum of equity and the absolute maximum debt, leaves no room for the business practices of Confluence Rivers. Any net operating losses resulting from post rate case acquisitions would reduce retained earnings and therefore equity.<sup>131</sup> This is a situation that already confronts us. Since the update period in this case ended on January 31, 2023, Confluence Rivers has closed on four systems (2 water and 2 sewer) that will not be included in the rates to be set in this case.<sup>132</sup> Other transactions have Commission approval and may be closed in the not-too-distant future.<sup>133</sup> Still other applications are pending.<sup>134</sup> Losses on acquired systems on an on-going basis is not a hypothetical situation. The only way to avoid the danger of debt covenant violations if Confluence Rivers were utilizing the highest debt percentage allowed, would be to no longer acquire systems that may drive further net operating losses.<sup>135</sup>

The Commission should use the actual capital structure of Confluence Rivers as the capital structures recommended by Public Counsel and Staff are not only hypothetical, but they are also unrealistic and ignore the circumstances with which Confluence Rivers must contend when purchasing small, distressed utilities.

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<sup>130</sup> Exhibit 209, Murray Direct, Schedule DM-D-3 C, page 11.

<sup>131</sup> Exhibit 18, Thies Rebuttal, pages 30-31.

<sup>132</sup> See Case No. WA-2023-0003 (water system closed June 20, 2023); Case No. WA-2023-0092 (water and sewer systems closed March 27, 2023); and Case No. SA-2023-0187 (sewer system closed May 30, 2023).

<sup>133</sup> See Case No. SA-2023-0215 (sewer system tariff sheets effective September 1, 2023); and Case No. WA-2023-0284 (water and sewers systems tariff sheets effective September 2, 2023).

<sup>134</sup> See Case Nos. WA-2024-0048 and SA-2024-0049 (water and sewer systems); and Case Nos. WA-2023-0450 and SA-2023-0451 (three sewer systems and one water system).

<sup>135</sup> Exhibit 18, Thies Rebuttal, pages 30-31.

### **3. Conclusion**

The Commission should utilize Confluence Rivers' actual capital structure of 68.56% common equity and 31.44% long-term debt for the purpose of calculating the rate of return in this case. Confluence Rivers recognizes that its actual capital structure is outside the range of common equity ratios maintained by the Utility Proxy Groups.<sup>136</sup> However, this situation may be addressed through a downward adjustment to the ROE rather than by completely ignoring the actual capital structure. Confluence Rivers witness Mr. D'Ascendis provided an example of this as he utilized a downward adjustment in the amount of 0.51% to reflect the current equity ratio.<sup>137</sup>

#### **D. Cost of Debt**

##### **What is the appropriate cost of debt to use in calculating the Company's rate of return?**

The final cost of capital issue is the cost of debt to use in the calculation of the rate of return. Confluence Rivers' appropriate cost of debt is 6.60%, which reflects the debt cost from the CoBank debt issuance approved by the Commission in December 2022.

Public Counsel witness Murray argues that the debt cost should instead be 6.23%.<sup>138</sup> Mr. Murray references "patronage credits," a function of Confluence Rivers' membership in CoBank, for this reduction in debt cost.

Patronage credits are not referenced in Confluence Rivers' loan agreement and are not guaranteed to be paid.<sup>139</sup> Confluence Rivers has no significant experience with the patronage credits, given that its loan has been in place for less than a year. Thus, there is no support in either

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<sup>136</sup> Exhibit 7, D'Ascendis Direct, page 19.

<sup>137</sup> Exhibit 7, D'Ascendis Direct, pages 52-55.

<sup>138</sup> Exhibit 209, Murray Direct, pages 4, 19.

<sup>139</sup> Exhibit 8, D'Ascendis Rebuttal, pages 48-49.

the test year or the update period (which ran through January 31, 2023) upon which to base a deviation from the debt cost contained in the debt instrument. The interest rate of the loan itself is the appropriate cost of debt to use.

Having said this, it was suggested by Public Counsel witness Murray that an alternative to reducing the debt costs for purposes of the rate of return, would be to capture any patronage credits received by the Company on a going-forward basis, with carrying costs based on the 6.60% interest rate.<sup>140</sup> Given its inexperience with this issue, the Company believes that deferral of any such amounts received to a regulatory liability account would be an acceptable treatment of this issue and eliminate any reason to reduce the contractual debt cost for the purpose of calculating the appropriate rate of return.

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<sup>140</sup> Exhibit 211, Murray Surrebuttal, p. 13.



## VI. ADVANCED METER INFRASTRUCTURE INVESTMENTS

Issue: Should the Commission disallow any costs related to AMI meter investments?

In its direct testimony, Public Counsel asserts that the Commission “should disallow the AMI attachment costs associated with Indian Hills and Hillcrest included in the test year.”<sup>141</sup> Public Counsel suggests that this disallowance is appropriate because “Confluence has not made the software investment to enable those customers to visualize 15-minute interval data of water usage (e.g., personalized online customer portal.”<sup>142</sup> Interestingly, while using such rationale to disallow such meter costs, Public Counsel readily acknowledges that the AMI attachments necessary to provide the data to populate such a “personalized online customer portal” would not be a “prudent investment.”<sup>143</sup>

While single-mindedly focused on the lack of a “personalized online customer portal” to support its misplaced disallowance of these AMI costs, Public Counsel fails to recognize the other benefits associated with the AMI meters at Indian Hills and Hillcrest. Specifically, in response to Public Counsel’s data request, Confluence Rivers indicated that these AMI meters also allow for: (1) quicker identification of high-use events and leak detection and (2) a decrease in operational expense by eliminating manual meter reading.<sup>144</sup>

In its direct testimony, Confluence Rivers indicated that as a result of a recently issued Request for Proposals (“RFP”) related to third-party operational costs, it was able to achieve a 5.53% reduction in monthly O&M cost.<sup>145</sup> Recognizing that Confluence Rivers’ annual third-party O&M costs are roughly \$1,694,426,<sup>146</sup> the annual O&M savings is approximately \$93,701.

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<sup>141</sup> Exhibit 206, Marke Direct, page 12.

<sup>142</sup> *Id.* at page 10.

<sup>143</sup> *Id.* at page 11.

<sup>144</sup> *Id.* at page 9.

<sup>145</sup> Exhibit 20, Thomas Direct, page 12.

<sup>146</sup> Exhibit 207, Marke Rebuttal, page 9.

A significant portion of this O&M savings is associated with the “decrease in operational expense by eliminating manual meter reading” at systems like Hillcrest and Indian Hills that results from the installation of AMI meters. In fact, the annual O&M savings reflected in this case is approximately 3½ times the annual cost (\$26,768)<sup>147</sup> of the Hillcrest and Indian Hills AMI meters.<sup>148</sup> Public Counsel completely ignores this operational benefit in its misplaced recommendation to disallow the costs of AMI meters.

Public Counsel’s recommendation to disallow AMI meter costs is also undermined by other evidence in the record. Underlying Public Counsel’s disallowance is the premise that Confluence Rivers has invested in more expensive AMI meters for the purpose of receiving enhanced earnings by earning a return on this investment. Again, that premise is directly contradicted by other evidence elicited in this case. Specifically, in its direct testimony, Confluence Rivers discussed the unique nature of the Margaritaville service area acquired in 2023.<sup>149</sup> Specifically, the Margaritaville service area is a distribution-only system with 400 customers and lacked any water meters. According to Public Counsel’s premise, that Confluence Rivers is driven by earnings to make imprudent investments, Confluence Rivers should be eager to install customer meters in the Margaritaville service area. That said, however, Confluence Rivers has concluded that the “installation of individual customer meters is cost prohibitive.”<sup>150</sup> Instead, under the assumption that all Margaritaville residential customer usage is homogenous, Confluence Rivers instead proposed to install just “two meters” for two random residential customers. As Confluence Rivers concluded, this “can be accomplished in advance of the next rate case and will allow for informed

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<sup>147</sup> Exhibit 208, Marke Surrebuttal, page 14.

<sup>148</sup> Annual Savings of \$93,701 / Annual Cost of \$26,768 = 3.5

<sup>149</sup> See, Case No. WA-2023-0003.

<sup>150</sup> Exhibit 20, Thomas Direct, page 29. Specifically, Confluence Rivers has quantified the cost of installing meters and meter pits at approximately \$313,600. *Id.*

ratemaking for Margaritaville **while avoiding the significant capital investment associated with a more widespread meter installation program.**<sup>151</sup> Clearly then, contrary to Public Counsel’s suggestion, Confluence Rivers is not driven by the desire to make unnecessary meter investments.

In the ultimate analysis, Public Counsel’s recommendation is misplaced. Confluence Rivers has demonstrated that it is not motivated to make unnecessary meter investment. That said, however, where meter investment can drive operational economies and benefits, Confluence Rivers will make those investments. Here, the investment in AMI meters at Hillcrest and Indian Hills helped to drive approximately \$93,701 of annual O&M savings. As such, Confluence Rivers should not be punished for making this investment.

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<sup>151</sup> *Id.* at pages 29-30.

## VII. OPERATIONS, MAINTENANCE, AND OVERSIGHT

Issue: With respect to operations, maintenance, and oversight—

- c. Should the Commission order a disallowance related to Confluence’s contract-based business model, and if so, how much?

Since 2014 when it began operations in Missouri, Confluence Rivers and its pre-merger affiliates have relied on a business model that utilizes non-affiliated third-party contractors to perform all O&M functions required to keep the Company’s water and wastewater systems functioning and in good repair, to perform all tests required by the MDNR, take measures necessary to ensure compliance with all applicable health, safety and environmental laws and provide safe and reliable service to customers. And this is the same business model followed in each of the 11 other states where CSWR-affiliated utilities currently operate.<sup>152</sup>

Todd Thomas, the Company’s Senior Vice President in charge of operational and management oversight, explained the rationale this business model as follows:

As with all water/wastewater systems, there is a need for licensed, experienced operators. Where systems and connections are concentrated, utilities may be able to cost-effectively employ such operators. In contrast, however, Confluence Rivers’ water and wastewater systems in Missouri are geographically dispersed across the state. . . . Given that systems currently owned by Confluence Rivers are geographically dispersed and given the number of connections served in Missouri at this time, it would be difficult for Confluence Rivers to cost-effectively employ an in-house workforce of sufficient size to perform all required O&M functions necessary to fulfill the objective of providing customers safe, reliable, and timely utility service at reasonable rates.<sup>153</sup>

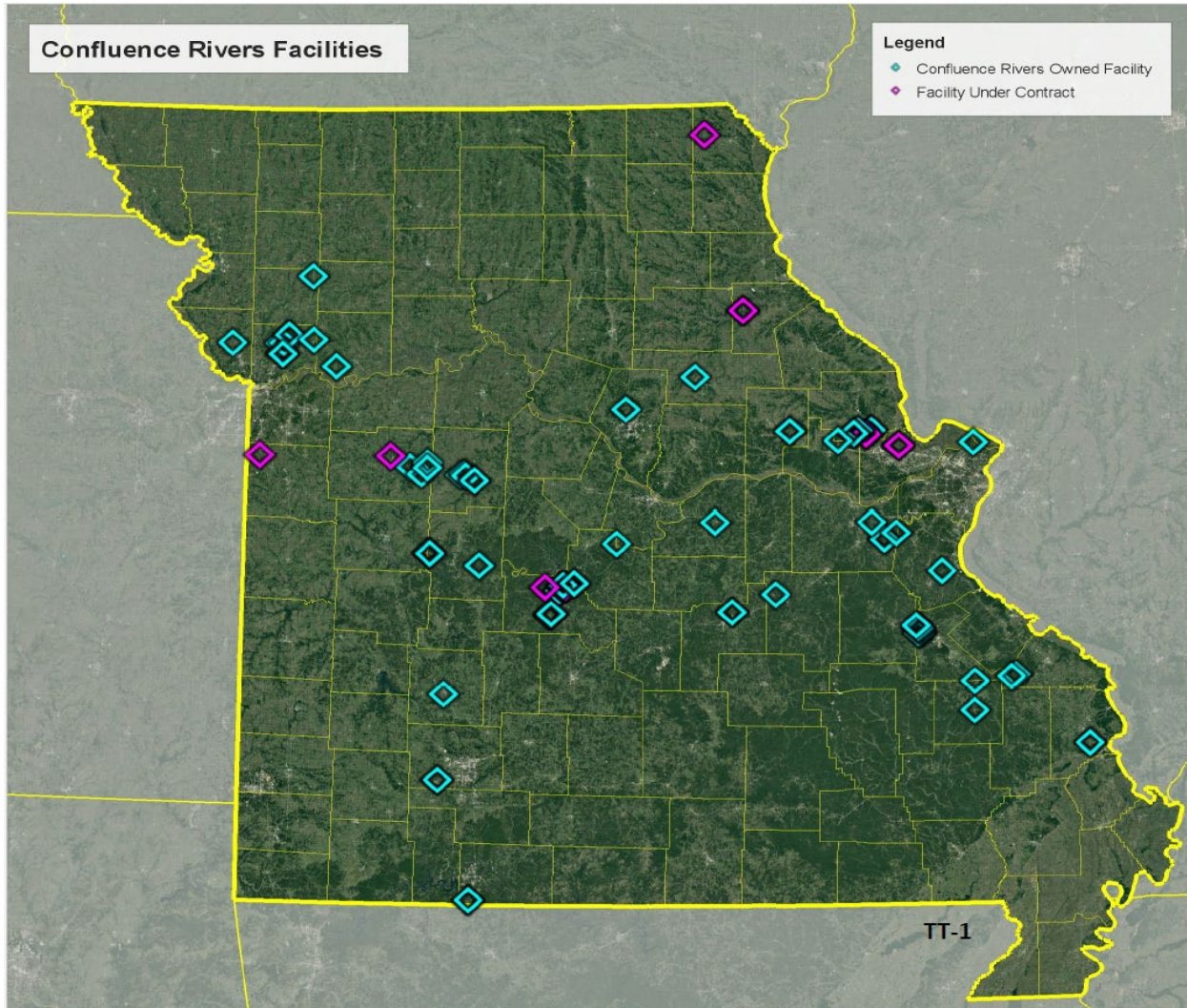
To graphically illustrate the accuracy of his statements regarding the Company’s dispersed geographic footprint, Mr. Thomas included with his direct testimony Schedule TT-1, which locates on a Missouri map all systems Confluence Rivers currently owns and operates or has under contract. That map, reproduced below, clearly shows the far-flung components of the Company’s

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<sup>152</sup> Exhibit 20, Thomas Direct, page 6.

<sup>153</sup> *Id.* page 5.

service area can be found near the Iowa border in the north and the Arkansas border in the south; near the Illinois border in the east and the Kansas border in the west; and within the state’s interior region at all points of the compass.



In his surrebuttal testimony, Mr. Cox provides further support for Mr. Thomas’s contention that employing an in-house workforce to satisfy the Company’s O&M requirements is neither practical nor cost-effective. Citing, as an example, the significant impact travel to and from the Company’s disaggregated systems has on the time it takes to complete required O&M tasks, Mr. Cox stated, “[t]he necessary implication of this dispersion is that Confluence Rivers does not have a density, such as displayed by Missouri American [Water Company], that allows an operator to

address a large number of systems in a particular day.”<sup>154</sup> Additional factors cited by Mr. Cox that strongly weigh against replacing third-party O&M contractors include: 1) an acute lack of qualified operators due to workforce aging, which would make hiring a sufficient number of employees difficult if not impossible, 2) governmental regulations—such as those imposed by the federal Occupational Safety and Health Administration—that mandate multiple employees are available to perform certain routine O&M tasks, 3) the nature and complexity of Confluence Rivers’ systems, and 4) system O&M responsibilities that include not only certified operators but also personnel with repair and construction skills.<sup>155</sup>

For these and other reasons, the Company’s use of contractors to perform all O&M functions represents the most prudent and cost-effective option currently available for the geographically dispersed and disaggregated systems Confluence Rivers and its outstate affiliates own and operate. That probably explains why in its five prior Missouri rate cases - Case Nos. WR-2016-0064, SR-2016-0202, WR-2017-0259, WR-2020-0053, and WR-2020-0275 - and in rate cases its affiliates have completed or filed in Kentucky, Louisiana, Mississippi, and Texas, no party has contended this aspect of CSWR’s business plan is unreasonable or uneconomical or recommended moving responsibility for O&M in-house.

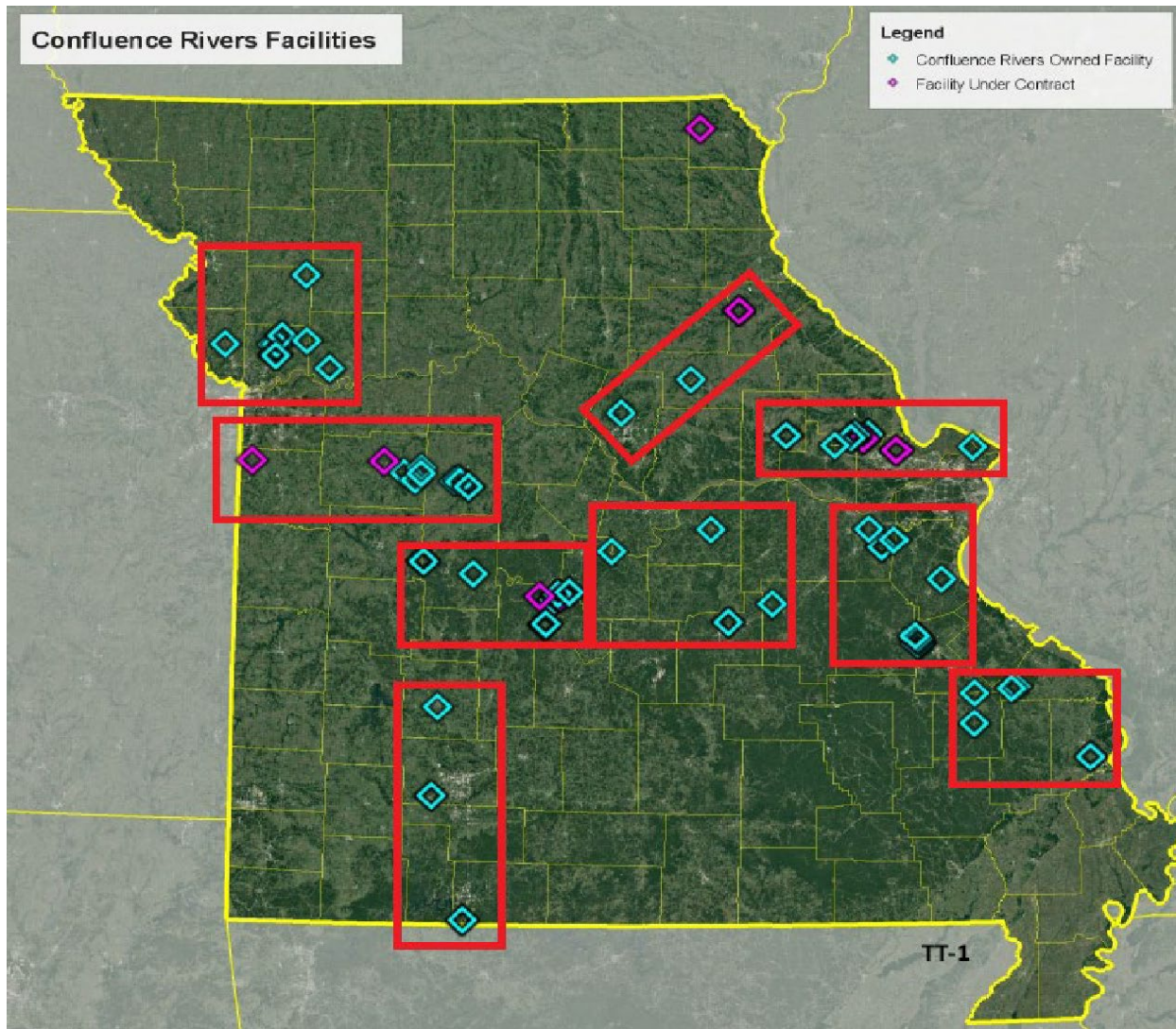
Despite the facts and considerations described above, Public Counsel claims it has a better idea, and has concocted a plan to displace third-party contractors and replace them with an in-house workforce that would assume responsibility for all the Company’s O&M activities statewide. Doing so, Public Counsel claims, would allow Confluence Rivers to reduce annual O&M costs from its test year estimate of \$1,694,426 to just \$600,000, an annual cost savings of

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<sup>154</sup> Exhibit 6, Cox Surrebuttal, page 39.

<sup>155</sup> *Id.* page 33.

more than \$1 million.<sup>156</sup> As explained by its witness Dr. Geoff Marke, Public Counsel's plan would divide the Company's service area into nine discrete divisions and make one, newly-hired employee solely responsible for all O&M activities within his or her division. A map showing the location of Dr. Marke's proposed divisions is reproduced below.<sup>157</sup>



<sup>156</sup> Exhibit 27C, Marke Rebuttal, pages 9-10.

<sup>157</sup> *Id.* page 12.

The specific water and wastewater systems included in each of those divisions are identified on Table 1: Breakdown of Proposed Operators to Water and Wastewater Systems, which can be found at pages 11 and 12 of Dr. Marke’s rebuttal testimony. It should be noted, however, that Dr. Marke’s proposal inexplicably omits one system the Company is seeking to acquire—the Village of Luray—which is the subject of a pending acquisition case.<sup>158</sup> That system is shown on Dr. Marke’s map in the extreme northeast corner of Missouri near the Iowa border, but it’s not included in or nearby any of the nine proposed divisions. Therefore, if the Commission approves the acquisition, it’s unclear who would provide O&M services for that wastewater system.

As the discussion that follows shows, Public Counsel’s proposal can most charitably be described as “half-baked.” It will not—and cannot—produce either the operational results or savings it claims. Simply stated, Confluence Rivers cannot provide required O&M services for all its far-flung Missouri water and wastewater systems for an amount even close to the \$600,000 Public Counsel proposes. The reasons for this and the defects in Public Counsel’s proposal are numerous. They include, but are by no means limited to, the following: the \$600,000 estimate of annual O&M expense grossly understates the actual cost of providing those services; the annual cost estimate includes no costs for items such as vehicles, tools, spare parts, and inventory, all of which are critical to the successful completion of required O&M; there is a wide disparity in the numbers of systems assigned to each of the nine divisions, which will materially affect the ability of some systems to fulfill all O&M requirements; and the proposal ignores the operational impracticalities of making a single person responsible for all O&M activities within a division, and also ignores requirements that likely would make such an arrangement unlawful.

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<sup>158</sup> Case No. SA-2023-0437.



**A. Public Counsel’s Proposal Grossly Understates the Cost of Providing O&M Services**

As previously noted, Public Counsel asks the Commission to disallow \$1,649,426, which is the estimated test year cost of third-party O&M contractors and allow in its place just \$600,000. According to Dr. Marke, this amount represents the cost for Confluence Rivers “to hire and train nine new full-time employees to oversee the Company’s Missouri water and wastewater assets full-time. These new full-time employees would then replace the need for Confluence to rely on their [sic] currently contracted vendors for water and wastewater operations.”<sup>159</sup> But this estimate includes only the wages and benefits Dr. Marke believes would be paid the new employees. As discussed in greater detail later in this brief, it includes none of the additional costs required to allow these employees to perform the O&M tasks for which they were hired. However, as record evidence in this case clearly shows, Public Counsel’s \$600,000 estimate is not even sufficient to cover salaries and benefits.

Public Counsel bases its salary and benefits cost estimate on an assumption that each of the nine employees it wants the Company to add could be hired for a base salary of \$48,220, a figure Dr. Marke derived from a 2021 Occupational and Wage Estimates study performed by the Missouri Economic Research and Information Center (“MERIC”). He then adjusts this base salary amount to account for benefits and taxes to arrive at a total compensation figure of \$60,000 for each proposed employee.<sup>160</sup> But nowhere in his testimony does Dr. Marke state or suggest he tested the sufficiency of the salary and benefits package estimate to determine whether any qualified candidates would be willing to accept the positions he proposes for that amount. So the Commission is left to rely on an estimate that may or may not accurately reflect the real-world market for qualified O&M operators.

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<sup>159</sup> *Id.* pages 9-10.

<sup>160</sup> *Id.* page 10.

As explained by the Company's witness Brent Thies, there are numerous reasons to believe Dr. Marke's estimates are not reliable. Confluence Rivers believes it would be inappropriate to use MERIC as the sole and only data set for setting salaries.

[I]t is impossible to determine what information was included in the study and what information was not. For example, employers are not legally required to provide information regarding the salaries and other compensation paid to their employees, so it is reasonable to believe many employers do not do so. Therefore, it is impossible to determine by just looking at the MERIC results whether it is representative of the employment market as a whole or only of those employers who agreed to provide salary and benefit information. If the study reflects the latter group, it is likely the salary ranges shown are skewed downward . . .<sup>161</sup>

In addition to his general reservations regarding MERIC data, Mr. Thies noted the data Dr. Marke used for his estimate were from a study using 2021 salary levels as a data source.<sup>162</sup> If adjusted to reflect the effects of cost-of-living factors of 5.9% for 2022 and 8.7% for 2023, the base salary for each of the nine positions Public Counsel proposes would increase to \$55,508.<sup>163</sup> And if that revised base is further adjusted to reflect average private sector benefits and taxes loadings of 29.5% (as determined by the United States Bureau of Labor Statistics) the fully loaded, 2023 compensation for each of Public Counsel's recommended new hires would increase to \$78,734.<sup>164</sup> Therefore, even excluding all other costs, and assuming nine entry level O&M employees could each be hired for the adjusted MERIC salary estimate, that salary and benefits total - \$708,606 - exceeds Dr. Marke's recommended annual O&M expense by more than \$100,000.

But even at the adjusted compensation amounts just described it is far from certain Confluence Rivers could fill the O&M positions Public Counsel proposes to add. For one thing,

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<sup>161</sup> Exhibit 18, Thies Rebuttal, page 18.

<sup>162</sup> Exhibit 19, Thies Surrebuttal, page 5.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.* page 6.

as will be discussed in greater detail later, each of those positions would be extremely demanding—so much so that it likely would be difficult, if not impossible, to hire and retain qualified candidates at any price. That challenge would be exacerbated by the fact Missouri’s unemployment rate was less than 3%—concern expressed in testimony by Mr. Thies<sup>165</sup> and echoed during the hearing by Commissioner Hahn.<sup>166</sup> In addition, because of what has been dubbed the “Silver Tsunami” utilities are concerned about the acute lack of skilled labor to fill available positions due to worker retirements. As expressed in an article published by the California Rural Water Association, “in the next five to ten years, more than half the most skilled water operators in [California] will retire. Folks in the water industry call it the “Silver Tsunami” because once these baby boomers leave, they’re taking decades of institutional knowledge with them along with their state certifications. It doesn’t sound like a big deal as an outsider looking in, but the impact to the water systems will be tremendous and long lasting.”<sup>167</sup>

Based on the foregoing, Public Counsel’s claim that by moving from contractors to in-house personnel Confluence Rivers can reduce annual O&M expense to just \$600,000 is nothing more than wishful thinking with no basis whatsoever in reality.

#### **B. Costs Missing from Public Counsel’s O&M Expense Estimate**

Public Counsel’s O&M proposal suffers from one fundamental and overarching defect: it’s author, Dr. Marke, has no hands-on experience with water or wastewater systems or facilities and no training, education, or experience in what’s required to design, operate, or maintain water and wastewater systems, generally, and more specifically, the systems owned and operated by

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<sup>165</sup> Exhibit 18, Thies Rebuttal, page 17.

<sup>166</sup> Tr. Volume 11, page 40. Note: In her question, Commissioner Hahn indicated that Missouri’s unemployment rate as of June 2023 was 2.6%. *Id.* at page 122.

<sup>167</sup> Exhibit 6, Cox Surrebuttal, page 35.

Confluence Rivers.<sup>168</sup> In contrast, the water and wastewater professionals who built and are responsible for operating the systems owned by the Company and its outstate affiliates have decades of combined experience in the design, construction, and operation of such systems. Moreover, they are responsible on a daily basis to ensure the more than 800 systems the affiliate group owns nationwide are properly maintained and operated in a manner that complies with applicable health, safety, and environmental laws and provide safe and reliable service to customers. The following statement from Mr. Cox succinctly captured the tremendous disparity between Dr. Marke's qualifications in this area and the qualifications and experience of Company personnel who made the decision to use third-party contractors to perform all O&M functions for Confluence Rivers and its affiliates: "After a decade in the industry, I can assure the Commission that the economics of staffing water/wastewater operations cannot be addressed simply by drawing boxes" on a map.<sup>169</sup>

Certain deficiencies in Dr. Marke's O&M cost analysis were described in the previous section of this brief. However, far more serious than the costs he included in his proposal but underestimated are the fundamental costs he completely ignored. And this glaring oversight, perhaps more than anything else, underscores how truly "half-baked" Dr. Marke's recommendation truly is.

Although he proposes the Company hire nine new employees and make them solely responsible for all O&M requirements within their respective divisions, Dr. Marke's O&M expense estimate includes no costs for tools, equipment, and supplies those employees would need to fulfill their job responsibilities. There is no allowance for vehicles, vehicle maintenance, or fuel that would allow each employee to traverse the hundreds or thousands of square miles for which

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<sup>168</sup> *Id.* page 32.

<sup>169</sup> *Id.*

he or she is responsible. Dr. Marke's cost estimate also includes nothing for tools, supplies, or a place to store both. Heavy equipment—like mowers and backhoes—also aren't included in the estimate, even though such equipment would be required to complete many of the tasks currently performed by third-party contractors.<sup>170</sup> Dr. Marke's estimate also includes no costs for spare parts inventories, generators, and other similar types of fixtures and equipment necessary to keep systems operational day in and day out.

It should be obvious to anyone, regardless of their level of experience, that operators alone aren't sufficient to meet Confluence Rivers' O&M needs and satisfy its requirements. Without the tools necessary to do the jobs he or she is charged to perform no employee can be successful. Yet Dr. Marke entirely ignored that truism when he prepared his estimate of the Company's annual O&M expense. Such a glaring error destroys the credibility of any proposal it afflicts. The fact it afflicts Public Counsel's proposal underscores the validity of a point made earlier in this brief: Simply stated, Confluence Rivers cannot provide required O&M services for all its far-flung Missouri water and wastewater systems for an amount even close to the \$600,000 Dr. Marke proposes.

### **C. Disparities in Public Counsel's Proposed Divisions Would Negatively Affect Service**

How Public Counsel would assign the Company's water and wastewater systems among the nine proposed divisions is shown on Table 1: Breakdown of Proposed Operators to Water and Wastewater Systems, which can be found at pages 11-12 of Dr. Marke's rebuttal testimony. The systems were assigned geographically and correspond with the boxes Dr. Marke drew on a map shown on page 12 of that testimony. But even a cursory review of either the table or the map

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<sup>170</sup> See Exhibit 233, which lists, in its Exhibit A, the numerous O&M tasks third-party contractors currently are required to perform. Those tasks include mowing and trimming of plant, lagoon, and rights of way and sewer and water main repair and replacement.

shows a significant imbalance among the proposed divisions. For example, the operator proposed for division 3 would be responsible for a total of 13 systems (7 water and 6 wastewater) while the operator in division 6 would be responsible for only 2 systems (1 water and one wastewater). But the disparity doesn't stop there. Under Dr. Marke's proposal, five of the proposed division operators would be responsible for no more than five systems each while four other operators would each be responsible for nine or more systems. This unequal division of responsibility almost certainly would make it difficult, if not impossible, for operators in some of the proposed divisions to timely fulfill all required O&M tasks.

The list of O&M tasks Confluence Rivers requires its third-party O&M contractors to complete can be found in Exhibit 233, which is a copy of the December 2022 contract between the Company and one of its contractors. The separate lists for water and wastewater systems are lengthy and include many time-consuming tasks. For example, O&M operators are required to make a minimum of three trips weekly to mechanical wastewater treatment plants and at least one visit per week to lagoon systems. Water system operators are required to make one or more weekly trips to each facility. Both water and wastewater system operators are required to perform line locates, as required, and water system operators are required to read meters monthly. Operators also are required to regularly perform tests required by MDNR, timely submit test results, and maintain records regarding both the tests and the results. Mowing and trimming plants growing around plants and on rights of way is another routine task that must be completed. In addition, O&M operators are responsible for all maintenance and repairs at all facilities. And perhaps most importantly, O&M operators are required to quickly respond to and resolve all customer service issues.

Because he has no experience operating or maintaining water and wastewater facilities, Dr. Marke has no knowledge, or appreciation, of how much time is required to fulfill all the O&M responsibilities the Company imposes on its third-party contractors. Whether an operator is responsible for 13 facilities (district 3) or only 2 (district 6), Dr. Marke either ignores the issue altogether or simply assumes the single employee he proposes to put in charge of each district will do whatever is required to keep those facilities running and in proper repair and maintenance. Dr. Marke also fails to consider the impact of “windshield time”—the time it takes an operator to travel between plants—on the operators’ ability to timely perform the work for which they were hired. And that’s not an insignificant oversight, because as Mr. Cox noted proposed district 3 encompasses an area more than 2,100 square miles in size.<sup>171</sup> Indeed, Mr. Cox succinctly summarized Dr. Marke’s numerous oversights and omissions as follows:

[R]ecognizing that Confluence Rivers inspects all mechanical facilities three times a week, operator #3 would have to make approximately 39 system inspections in a five-day week. If each inspection took just one hour, operator #3 would have 39 hours/week devoted just to inspections. This would leave one hour in the week for his travel time across the 2,150 square mile area or responsibility. Additionally, this leaves zero time for additional duties. For instance, if operator #3 identifies a problem at a system, he would have no time to take corrective actions as such actions would prevent the operator from getting to his next system of responsibility and conducting an inspection. Such simple considerations are completely ignored by Dr. Marke’s elementary map drawing.<sup>172</sup>

In addition to the worktime considerations already discussed, the Commission should not lose sight of another glaring defect in Dr. Marke’s proposal – it includes no allowance for overtime pay if operators are unable to complete assigned tasks within a standard, forty-hour workweek. Because, as was shown previously, the \$600,000 annual expense amount Public Counsel proposes to include for test year for O&M isn’t sufficient to fully cover salary and benefits for the nine

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<sup>171</sup> Exhibit 6, Cox Surrebuttal, page 34.

<sup>172</sup> *Id.*

operators, there obviously is no amount of allowed expense available for overtime. Does Public Counsel believe maintenance issues or customer service emergencies that arise after an operator has completed a full forty-hour work can or should be deferred to the following week? One can only wonder.

**D. Operational Impracticalities of Public Counsel's Proposal**

Although some operational issues related to disparities in the numbers of Confluence Rivers' systems assigned to each of Dr. Marke's proposed divisions were described in the previous section, additional factors that render his proposal operationally impractical, and perhaps unlawful, also should be noted. Any plan that makes a single employee solely responsible for all O&M tasks and requirements for one or more specified water and wastewater systems is inherently flawed for numerous reasons. Who is responsible for those systems on a back-up basis if the single employee who is primarily responsible is unavailable because of illness, vacation, or any other planned or unplanned absence? What about legal holidays, which impact all divisions simultaneously – who's responsible for the facilities then? And who takes over O&M for a district while its primary operator attends one of the training courses Dr. Marke describes at page 14 of his rebuttal testimony?

But beyond these inherent flaws, is Public Counsel's proposal reasonable when judged against O&M requirements specific to Confluence Rivers? The numerous duties and responsibilities the Company imposes on its third-party contractors have been referenced several times already in this brief. But three specific requirements are particularly germane to this discussion. Contractors currently are required to: 1) maintain a 24-hour, seven days per week maintenance and emergency phone line for customer utility disruption events; 2) provide 24-hour on-call emergency utility response for all operations; and 3) respond to all customer calls and



notifications within two hours of receiving a call. These requirements create a significant burden for the Company's contractors, but they are essential if Confluence Rivers is to fulfill its obligation to customers to always provide safe and reliable water and wastewater services. If Dr. Marke's proposal is accepted, the Company—as well as the Commission and Public Counsel—almost certainly would expect the nine in-house operators to provide the same or a substantially similar level of service. But if these service requirements create a substantial burden for contractors the corresponding burden for an operator solely responsible for all O&M activities within his or her district can only be described as oppressive. How difficult would it be for Confluence Rivers to recruit and hire employees for a job that requires them to be on duty 24 hours a day, 7 days a week, and 365 days a year – all while being paid for just 40 hours per week? And even if the Company can hire operators willing to take such a job, is it likely they could retain them?

Dr. Marke either doesn't know or fails to appreciate the significant burdens his proposal would put on each of the operators he wants Confluence Rivers to hire. He also doesn't understand how unreasonable it would be to expect qualified operators to accept such burdens if other less burdensome employment opportunities are available.

Another defect in Public Counsel's proposal stems from the fact Dr. Marke seems to assume the functions of an O&M operator are limited to inspections designed to comply with MDNR regulations. That assumption is incorrect. That is clear from even a cursory review of the list of duties and responsibilities the Company imposes on its O&M contractors.<sup>173</sup>

[A]n operator's work goes well beyond simple inspection. In addition, when systems fail these operators are also tasked with performing repairs as systems fail. For example, when pumps, blowers and aerators need replacing, the operators are generally expected to perform such replacements. . . . Given the distressed nature of the systems acquired by Confluence Rivers, these repair responsibilities are significant and time consuming.<sup>174</sup>

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<sup>173</sup> Exhibit 233.

<sup>174</sup> Exhibit 6, Cox Surrebuttal, pages 38-39.

Mr. Cox further testified that technicians who perform the types of duties described above are paid at a much higher rate than plant operators,<sup>175</sup> which provides further shows how inaccurate Dr. Marke's estimates were regarding the annual cost of employees required to perform necessary O&M work for Confluence Rivers.

Dr. Marke also doesn't seem to understand or appreciate that the single operator structure he proposes also is most likely unlawful. Mr. Cox described this additional defect in Public Counsel's proposal as follows:

It is my understanding, given my past experience as well as from talking to the Vice President at Clearwater Solutions, Confluence Rivers' single largest operator, that the Occupational Safety and Health Administration ("OSHA") has issued numerous regulations involving worker safety that are applicable to the water and wastewater industry. For instance, OSHA has promulgated rules regarding the number of workers that must be present whenever work involves a confined space.

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The primary implication to this discussion of work performed in a confined space, such as that detailed in sewer systems, is that work cannot be performed by a single individual. Specifically, OSHA regulations mandate that, when work is performed in a confined space an attendant be stationed outside the confined space. In addition, an entry supervisor must also be present. Therefore, contrary to Dr. Marke's suggestion that a single operator can handle all functions in his assigned area, OSHA would deem such actions unlawful.<sup>176</sup>

Considering all relevant costs and O&M requirements, Mr. Cox and Mr. Thies estimate Confluence Rivers would need at least twenty-two additional employees to replace the third-party O&M contractors it currently uses. And the annual cost would not be \$600,000 as Public Counsel suggests but would, instead, be approximately \$2.25 million<sup>177</sup>—an amount that exceeds the amount of O&M expense proposes to include in its test year cost of service by more than half a

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<sup>175</sup> Tr. Volume 11, page 27.

<sup>176</sup> Exhibit 6, Cox Direct, pages 36-37.

<sup>177</sup> *Id.* page 40.

million dollars. So rather than save money, replacing third-party O&M contractors with in-house personnel would be much more expensive than is currently the case.

Based on the foregoing, Dr. Marke's O&M proposal in this case can best be described as follows: underfunded, operationally impractical, and likely unlawful. For any and all these reasons, the Commission should reject that proposal in its entirety.

**E. Staff's and Confluence Rivers' Alternative**

In contrast to what Public Counsel proposes, as part of their non-unanimous stipulation Staff and the Company offer an alternative if the Commission believes further study of the Company's use of third-party contractors is warranted. Under that proposal, within nine months of the Commission's Report and Order in this case, Confluence Rivers would present to both Staff and Public Counsel a formal study that includes a cost/benefit comparison of the use of third-party contractors versus in-house personnel to perform required O&M tasks. The formal study would include, but not be limited to, the location of Confluence Rivers' systems (including the distance between those systems), the age and condition of the systems, the types of technology employed at each system, the O&M services required by each system, the number of operators required to perform those services, and the compensation such operators likely would require. All parties would then meet within ninety days of the report to discuss the Company's findings and conclusions. Confluence Rivers would update its study prior to its next general rate case so that any party wishing to challenge the Company's findings could do so in that case.

Unlike Dr. Marke's proposal in this case, the option proposed by Staff and the Company would allow a thorough analysis and review of all issues and costs germane to how O&M services can be most competently and cost-effectively performed withing Confluence Rivers' dispersed service area.

## VIII. CONCLUSION

For all the reasons expressed in this brief, and based upon the competent and substantial evidence in the record, Confluence Rivers recommends that the Commission adopt the following positions:

1. Income Taxes: Consistent with all other Missouri rate cases, as well as the Staff's past position in Confluence Rivers' rate cases, Confluence Rivers recommends that the Commission include a normalized level of income taxes in the revenue requirement in this case.

2. Acquisition-Related Costs: The systems acquired by Confluence Rivers were in significant states of disrepair due to significant deferred maintenance, improper operations and depreciated assets that were not properly replaced. Absent the incurrence of the acquisition-related costs, the acquisition would never occur. These costs are a necessary component of operations in the present and the future.<sup>178</sup> The Commission should deny Staff's proposed disallowance of these costs and allow them to remain in Confluence Rivers' rate base.

3. Timesheets: Because Staff has failed to demonstrate its proposal to require CSWR's executives to maintain daily timesheets would provide any benefits – because time charged to “All Companies” under such an arrangement would still need to be apportioned using an allocation factor – and because adoption of a consolidated rate structure would obviate any need to record time at a system or tariff district level, the Commission should reject Staff's timekeeping proposal. Instead, the Commission should free executives (director and above) from the obligation to maintain timesheets. In the alternative, Confluence Rivers asks that it be allowed to implement the Project Time Tracking system proposed by Mr. Thies. Under either scenario, employees below the director level would continue to keep timesheets.

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<sup>178</sup> Exhibit 18, Thies Rebuttal, pages 11-12.

4. Cost of Capital: An appropriate ratemaking capital structure for Confluence Rivers given its size and the nature of its operations consists of 31.44% long-term debt at a cost rate of 6.60% and 68.56% common equity at a return on common equity of 11.35%.<sup>179</sup>

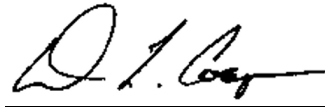
5. Advanced Meter Infrastructure Investments: The AMI investment at Hillcrest and Indian Hills helped to drive approximately \$93,701 of annual O&M savings in the form of meter reading savings. This annual savings greatly exceeds the annual return of an on investment (\$26,76) for the Hillcrest and Indian Hills AMI meters. As such, Public Counsel's proposed disallowance of the cost of AMI meters at Hillcrest and Indian Hills is misplaced.

6. Operations, Maintenance, and Oversight: The Commission should adopt the position of Confluence Rivers and Staff as set forth in their non-unanimous stipulation. That proposal would require the Company to perform a formal cost/benefit study of moving responsibility for O&M in-house as opposed to continuing to use third-party contractors. The results of the study would then be shared with Staff and Public Counsel for their review and critique. The study also would be updated prior to Confluence Rivers' next general rate case.

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<sup>179</sup> Exhibit 9, D'Ascendis Surrebuttal, page 1.

Respectfully submitted,



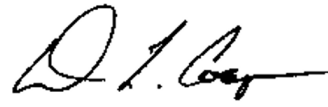
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**ATTORNEYS FOR CONFLUENCE  
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COMPANY, INC.**

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.



Dean L. Cooper

Dated: September 8, 2023