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

In the Matter of Confluence Rivers Utility)
Operating Company, Inc.'s Request for) **Case No. WR-2023-0006**
Authority to Implement a General Rate)
Increase for Water Service and Sewer)
Service Provided in Missouri Service Areas)

STAFF'S REPLY BRIEF

Respectfully Submitted,

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September 19, 2023

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In the Matter of Confluence Rivers Utility)	
Operating Company, Inc.'s Request for)	<u>Case No. WR-2023-0006</u>
Authority to Implement a General Rate)	Tariff Nos. YW-2023-0113
Increase for Water Service and Sewer)	and YS-2023-0114
Service Provided in Missouri Service)	
Areas)	

STAFF'S REPLY BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and tenders this *Reply Brief*, in satisfaction of the Commission's *Order Granting Motion to Amend Procedural Schedule*, issued herein on April 25, 2023:

Introduction:

In its *Initial Brief*, Confluence urges the Commission to look at the “big picture.” That picture is one that shows Confluence doing the good work of acquiring and rehabilitating decrepit, inadequate, even dangerous small systems throughout Missouri and several other states. Staff applauds the good work that Confluence is doing in that regard. But Staff reminds the Commission that its first duty in this general rate case is to scrutinize Confluence’s spending and operations to ensure that its customers are getting the services they are paying for, and that they are paying for no more than the services they get.

Confluence highlights its examination of Kim Bolin, who directs Staff’s auditors:

Q. 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.***¹

Confluence characterizes Ms. Bolin's answer as "disconcerting."² But the reality is that the question posed to Ms. Bolin, like the question posed to Ms. Vito in *My Cousin Vinny*, is a trick question: an audit looks at how money has been spent, not at how it will be spent in the future. It would be grossly improper for anyone on Staff to "consider how auditing positions may impact acquisition or non-acquisition of distressed systems," because that is not an auditing issue. Instead, that is a policy issue. And Staff has provided guidance to the Commission on that policy issue in its *Initial Brief*, under the heading "Incentives."

Misstatements characterize Confluence's *Initial Brief*. For example, also in its introduction, Confluence states: "Despite the regulatory obstacles constructed by Staff and Public Counsel, Confluence Rivers has now acquired, with the Commission's assistance, 68 distressed water / wastewater systems in the state of Missouri."³ If Staff was in fact opposed to these acquisitions by Confluence, it is doubtful that they would have occurred. As stated above, Staff applauds Confluence's good work of acquiring and rehabilitating decrepit, inadequate, and dangerous small systems throughout Missouri. But that does not entitle Confluence to pillage its ratepayers.

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¹ *Confluence's Initial Brief*, p. 3.

² *Id.*

³ *Id.*, p. 4.

Argument:

With respect to the several issues submitted to the Commission for resolution, Staff states:

1. **Income Taxes:**

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?

The Company seeks to recover in rates, with respect to Income Tax expense, an amount that is more than it will ever actually pay to the IRS or the Missouri Department of Revenue (“DOR”), expressly as a recovery for operating losses sustained between the acquisition and the effective date of new rates. As Confluence stated in its *Initial Brief*, “In any event, as a result of the deflated rates and increased operating expense, Confluence Rivers always incurs a net operating loss upon acquired [*sic*] a distressed system.”⁴

Confluence’s Position is Unlawful:

Staff has already explained, in its *Initial Brief*, that the Commission cannot lawfully adopt Confluence’s position. It violates both the prohibition against retroactive

⁴ *Id.*, at pp. 16-17.

ratemaking and the requirement that rates be just and reasonable.⁵ So, even if the Commission did what Confluence urges it to do, the Court of Appeals would require the Commission to undo it.⁶ Staff has also explained, in its *Initial Brief*, what the Commission can do, if it is so inclined, which is to set Confluence's ROE higher than it otherwise would.⁷ That does not mean, of course, the outrageous and unjustified ROE proposed by Mr. D'Ascendis (11.35%), but rather one at the higher end of the reasonable range proposed by Mr. Walters (9.5%-9.8%).⁸

The Phantom "Double Benefit":

Confluence complains that Staff's position confers a "double benefit" upon the ratepayers: first, the benefit of Confluence's operation of the system at a loss, and second, the benefit of not paying income tax due to the NOLs. Confluence again seeks to misdirect the Commission. Because businesses only pay income tax on net revenues, a business that operates at a loss enjoys the benefit of no income tax liability. Confluence is enjoying that benefit now. Businesses that operate at a loss may also carry those losses forward as NOLs to shelter future positive net revenues from taxes on a dollar-for-dollar basis. Confluence will enjoy that benefit in the future when it has positive net revenues.

⁵ *Staff's Initial Brief*, pp. 6-8.

⁶ Assuming, as is likely, that the Public Counsel appeals an adverse result.

⁷ *Staff's Initial Brief*, pp. 8-9.

⁸ Staff also explained why the Commission need not, and should not, do this. *Id.* The range 9.5%-9.8% represents Mr. Walters' midpoint to his upper limit. *Staff's Initial Brief*, p. 28, Table 2.

What about the benefits that Staff is depriving Confluence of and handing to the ratepayers? The first is the benefit the ratepayers receive when Confluence buys a system and operates it despite the fact that rates are inadequate. That's called regulatory lag and it is something every utility experiences. It is the interval between a change in the revenue requirement and the recognition of that change in rates. It is a normal cost of doing business as a utility. A utility can reduce regulatory lag by initiating a rate case as soon after the acquisition as possible. The cost of operating a system comes with the CCN that authorizes Confluence to own and operate the system. This is not an improperly transferred benefit.

The second is the benefit conferred by the NOLs. In addition to the undeniable benefit of using the NOLs to shelter future revenue from income tax liability, Confluence wants the added benefit of collecting money from ratepayers to cover the income taxes it will never pay. That's not a benefit, that's robbery! And, as Staff has explained, like robbery, it is illegal.

Staff's Purported Change of Position:

Confluence places great reliance upon what it characterizes as Staff's change of position.⁹ At the hearing, it appeared that several of the Commissioners were disturbed that Staff seemed to be inconsistent. The explanation is straightforward – Confluence's rate case presents issues not encountered in small company rate cases, and the examples that Confluence cites are all small company rate cases. Confluence is a large

⁹ *Confluence's Initial Brief*, pp. 17-20.

company, despite the fact that it operates numerous small systems. Staff assumes large companies will come in for rate cases every three years. The evidence is that Confluence will have no income tax liability over the next three years, or even longer, due to its NOLs.¹⁰ Consequently, Staff proposed the inclusion in rates of only a very small amount of money for income tax.

Confluence's Threats:

As other utilities have done from time-to-time, in other rate cases, Confluence threatens to take its acquisition money and spend it elsewhere should the Commission not award it the bloated and unjust rates it seeks. Staff urges the Commission to call that bluff. The other states in which Confluence operates make rates on the same principles as Missouri. Confluence's rate cases in those states are likely to yield similar results. In any case, with 60 systems in Missouri, Confluence isn't going anywhere.

Conclusion:

As in its *Initial Brief*, Staff urges the Commission to include a just and reasonable amount in rates with respect to Confluence's income tax liability going forward. That amount is \$31,465.¹¹

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¹⁰ "Q. When do you envision there coming a time for you to have to start paying taxes on the investments you've made? A. Yeah. I believe Mr. Thies testified on that. I think it's a number of years from now. So it's, you know, three, four, or five years from now is when, you know, those NOL's, if you will, will run out." Tr. vol. 9.5, p. 33, ll. 3-8 (testimony of Josiah Cox).

¹¹ *Staff's Initial Brief*, p. 10.

2. Acquisition-Related Costs:

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

In its *Initial Brief*, Confluence states: “In acquiring ... 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.”¹² Confluence attempts to justify its recovery of these acquisition costs by pointing to the definition of USOA 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.¹³

Notice that the description of Account 183 refers to “projects.” This account is for preliminary expenditures incurred in constructing a capital asset, not acquiring one. If Confluence builds a water tank at one of its facilities, for example, the preliminary legal and engineering expenses should indeed be treated as Confluence proposes here. But the same treatment does not apply if Confluence instead buys a system.

Confluence’s capital assets are the property of Confluence’s owners. The expenses of acquiring property for Confluence’s owners are therefore properly borne by Confluence’s

¹² *Confluence’s Initial Brief*, p. 23.

¹³ *Id.*, p. 24, citing Ex. 18, Thies Rebuttal, page 10 (emphasis added).

owners. Why should the ratepayers pay for property that they don't own and that does not yet benefit them? Indeed, they should not. It's just that simple.

In its *Initial Brief*, Confluence states:

The 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).¹⁴

As Staff pointed out in its discussion of the previous issue, large companies may well be treated differently than small companies. That is the case here. The small companies Confluence references were all in terrible physical and financial shape. Mindful of those circumstances, Staff took a very gentle approach in those rate cases. It is no benefit to the ratepayers, after all, if the system they depend on fails. The present rate case is a different matter. Confluence is a large and sophisticated utility company that operates in multiple states. Its financial condition is good and the physical condition of its systems is either good or being improved. Therefore, Staff has treated it the same way it treats every large utility company.

At the hearing, Staff's witness Keith Majors testified that an item-by-item review might establish that some costs were in fact beneficial to ratepayers and should therefore be recovered via a five-year amortization, without rate base treatment.¹⁵ It is not too late

¹⁴ *Confluence's Initial Brief*, pp. 24-25.

¹⁵ Tr. 9.5, p. 91, l. 7, through p. 93, l. 16.

for Confluence to seek an AAO for such costs and, working cooperatively with Staff's auditors, identify those expenses appropriate for deferral treatment. In its *Initial Brief*, Confluence states:

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. 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.¹⁶

Staff reminds Confluence that “[a]t any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the [utility].”¹⁷ This includes the burden of going forward with the evidence and the risk of non-persuasion.¹⁸ It was not Mr. Majors’ burden to root out the material facts concerning these expenditures, it was Confluence’s. Perhaps Confluence would have obtained a happier result had it cooperated with Staff’s audit, marshalled these facts, and presented them to Mr. Majors.

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3. Timesheets:

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 their initial brief, CSWR notes that commissioners are exempt from keeping timesheets, because their time is devoted to Missouri utilities in a general sense.¹⁹ Similarly,

¹⁶ *Confluence’s Initial Brief*, p. 28.

¹⁷ Section 393.150.2, RSMo.

¹⁸ *Kinzenbaw v. Director of Revenue*, 62 S.W.3d 49, 53 (Mo. banc 2001).

¹⁹ *Initial Brief of Confluence Rivers Utility Operating Company, Inc.*, p. 32.

CSWR argues, their executives continue to devote more and more time to “All Companies” and therefore, should be exempt from keeping timesheets.²⁰ However, the duties of commissioners and CSWR executives are not as similar as CSWR would like the Commission to believe. First, commissioners are political appointees working for a regulatory agency; they decide cases brought before them after hearing evidence from all parties involved. CSWR executives are employees of a private company; while utility companies must provide their customers with safe and adequate service, they must also aim to earn a profit. Even if CSWR executives are devoting more and more time to the company as a whole, Staff needs timesheets to verify that information and to see what amount of time is still being devoted to individual systems within Missouri. CSWR is asking the Commission to trust their estimation of how executives’ time is spent, but CSWR has continually shown, as discussed in Staff’s *Initial Brief*, that they cannot be trusted to abide by Agreements that CSWR was a party to and that were eventually approved by the Commission.

Casi Aslin.

4. Advanced Meter Infrastructure Investments:

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

Staff takes no position on this issue.

²⁰ *Id.*, at p. 31.

5. Cost of Capital:

With respect to the 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?**

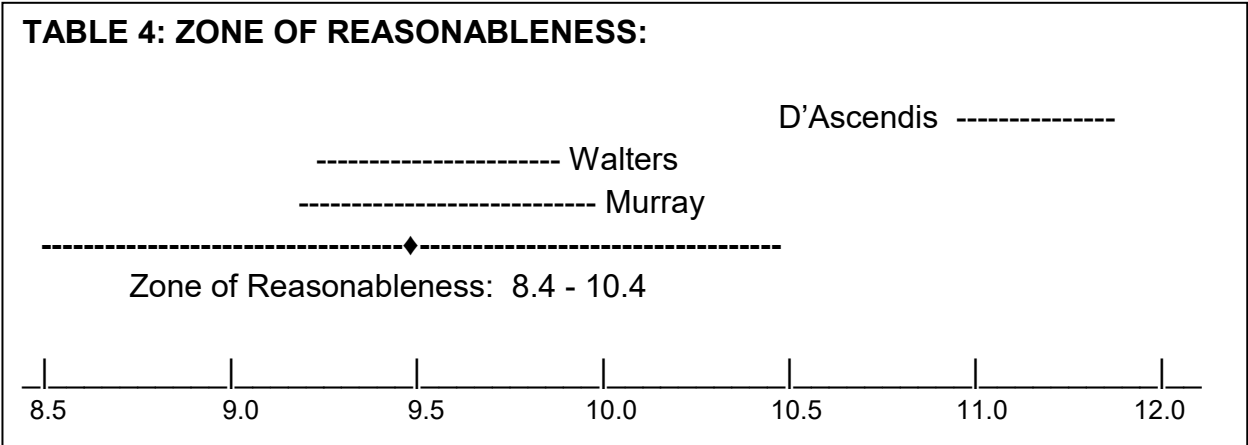
Introduction

In determining rates, a regulatory body is “not bound to the use of any single formula or combination of formulae.” The question is whether the regulatory body's “order ‘viewed in its entirety’ meets the requirements” of the law. It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry ... is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.²¹

The quotation above is offered to help the Commission keep its eye on the prize. Don't be beguiled by the rhetorical flourishes of Confluence's able counsel or the smoke-and-mirrors deployed by Confluence's expert, Mr. D'Ascendis. It's the result that matters, not how you get there. Table 4, below, reproduced from Staff's *Initial Brief*, provides a

²¹ *State ex rel. Office of Public Counsel v. Public Service Com'n*, 367 S.W.3d 91, 108 (Mo. App., S.D. 2012) (internal citations omitted).

graphic depiction of the reason that Confluence’s cost of capital recommendations should be discarded: they lead to a result that is unjust and unreasonable.



Capital Structure:

Mr. D’Ascendis, testified that Confluence’s actual capital structure consists of 68.56% equity.²² However, in response to Staff Data Request 0183, the Company admitted that its actual equity ratio was only 16.19% as of year-end 2022.²³ This fact alone should end any discussion of a capital structure containing 68.56% equity.

Staff’s witness, Chris Walters, proposed a capital structure that is fair to the Company, fair to the ratepayers, and in line with the average DTE of the proxy group: 50:50. Mr. D’Ascendis, on the other hand, urges the Commission to use his entirely fictitious, equity-heavy capital structure, in order to reach a higher ROR. The Commission should just say no to Confluence.

²² *Id.*, p. 15, ll. 8-11.

²³ Ex. 109, Walters Direct, p. 23, ll. 2-8.

Cost of Debt:

Staff and the Company are in agreement on the cost of debt: 6.60%.

Return on Equity:

In its *Initial Brief*, Staff summarized the many flaws that Mr. Walters found in Mr. D'Ascendis' methodology and pointed out in his rebuttal testimony. In the final analysis, however, as the quote set out at the beginning of this discussion plainly states, it is the result that counts, not the methods used to get there. Table 4 from Staff's *Initial Brief*, reproduced above, depicts graphically that Mr. D'Ascendis' recommended ROE range is entirely outside of the Zone of Reasonableness, while the recommendations of Mr. Walters and Mr. Murray are within it. The Zone of Reasonableness method is founded squarely upon the Principle of the Commensurate Return announced in ***Hope*** and ***Bluefield***, the two decisions of the United States Supreme Court that set out the constitutional parameters applicable to the Commission's resolution of the cost of capital issues. Too low, and the Company is subjected to an unlawful confiscation of its property; too high, and the ratepayers are deprived of Due Process. The sweet spot, the middle ground where the Commission lawfully can set the ROE, is described by the Zone of Reasonableness. Staff urges the Commission to set Confluence's ROE within that Zone, as recommended by Chris Walters and echoed by David Murray, thereby providing a return to Confluence that meets the requirements of the law and adequately funds its capital costs.

Cost of Capital Conclusion:

In its *Initial Brief*, Confluence asserts that it is “recognized as riskier than the traditional water company” and cites this point as justification for a high ROE.²⁴ This assertion is cited to the testimony of Mr. D’Ascendis.²⁵ But is Confluence really any riskier?

In each of its 60 plus Missouri systems, Confluence is the monopoly provider of one or more of life’s necessities. Confluence has assured the Commission that its very first action upon acquiring a system is to rehabilitate its facilities and bring them up to an appropriate operating standard. Many before and after pictures were shown at the hearing and appear even in Confluence’s *Initial Brief*. The Company is justly proud of what it has achieved. While the rates in those systems have historically been inadequate, the present case will fix that problem. There is no reason to suppose that Confluence will not, henceforward, collect revenues sufficient to cover the cost of providing service, including its capital costs. There is no reason to suppose that its newly rehabilitated systems will fail. So, just how is Confluence more risky?

The suggestion that Confluence is entitled to a higher return because it is doing good work by acquiring and rehabilitating decrepit water and sewer systems or because its owners have taken on a particularly risky business model is frankly absurd. The public utility business is one of the safest out there. People have to buy the service; they have no choice. There is no competition. The sovereign ensures that the rates are adequate. It is, in fact, a gold mine. Why else would Confluence be doing it?

²⁴ *Confluence’s Initial Brief*, p. 37.

²⁵ Tr. vol. 10, p. 40, ll. 11-16.

Both Mr. Walters and Mr. Murray evaluated the likely credit rating impact on Confluence of their cost of capital recommendations.²⁶ Mr. Walters testified, “no matter which metrics you look at, their credit rating would be a very strong investment-grade rating.”²⁷ Based on all of the foregoing, Staff urges the Commission to adopt Staff’s positions as explained by Mr. Walters and award Confluence an ROR of 8.05%, based on a 50:50 capital structure, a cost of debt of 6.60%, and an ROE of 9.50% within a reasonable range of 9.2% to 9.8%.

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**6. Operations, Maintenance, and Oversight:
With respect to operations, maintenance, and oversight—**

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

Staff does not support the disallowance proposed by OPC.

Conclusion

On account of all the foregoing, the Commission should resolve each disputed issue as recommended by the Staff; and grant such other and further relief as the Commission deems just in the circumstances.

²⁶ Tr. vol. 10, p. 77, l. 25, through p. 80, l. 1 (Walters); Tr. vol. 10, p. 138, l. 12, through p. 140, l. 16 (Murray).

²⁷ Tr. vol 10, p. 79, l. 24. Through p. 80, l. 1.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **19th day of September, 2023**, to the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

/s/ Kevin A. Thompson