BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

In the Matter of Confluence Rivers 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 YS-2023-0114

REPORT AND ORDER

Issue Date: October 25, 2023

Effective Date: November 4, 2023

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REPORT AND ORDER

Procedural History

On December 21, 2022, Confluence Rivers Utility Operating Company, Inc. (Confluence Rivers or “the Company”) filed proposed tariffs to produce an additional $1,286,748 in annual water revenues from 26 water service areas and an additional $1,862,116 in annual sewer revenues from 39 sewer service areas.[1] The proposed rate changes differed by service area due to the variety of rates currently in use. The tariffs had a proposed effective date of January 20, 2023.

The Commission set the test year to be the twelve-month period ending June 30, 2022, with an updated/known and measurable period through January 31, 2023, with no true-up period. To allow sufficient time to study the effect of the tariff sheets and to determine if the rates established by those sheets are just, reasonable, and in the public interest, the proposed tariffs were suspended until November 20, 2023.[2]

The Commission directed notice of the filings and set an intervention deadline. No requests to intervene were received.

A series of six local public hearings were held between the dates of June 12 and June 26.[3] An evidentiary hearing was held from August 10 to 16.[4] Prefiled testimony was filed according to the procedural schedule. Exhibits and live testimony were provided during the evidentiary hearing, including two post-hearing exhibits. Initial post-hearing briefs were filed on September 8, and reply briefs on September 19.

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[1] File No. SR-2023-0007 was consolidated into File No. WR-2023-0006 on January 4, 2023.
[2] From this point forward, date references are to 2023 unless otherwise noted.
[3] Transcript Volumes (Tr. Vols.) 1-6.
[4] Tr. Vols. 8, 9, 9.5, 10, 10 in camera, and 11. The Commission acknowledges the unique numbering.

The parties reached agreement on a number of issues and submitted a Unanimous Partial Stipulation and Agreement as well as an unopposed Nonunanimous Partial Stipulation and Agreement. After the Commission approved both agreements,[5] six issues as presented by the parties remained for Commission decision. This Report and Order addresses those six remaining issues.

General Findings of Fact

1. Confluence Rivers is a certificated Missouri "water corporation", "sewer corporation", and "public utility" as those terms are defined at Section 386.020, RSMo (Supp. 2022).

2. Confluence Rivers has certificates of service for water and/or sewer service in 27 non-contiguous Missouri counties.[6] Confluence Rivers owns and operates 26 water systems across Missouri.[7]

3. The Commission approved the consolidation/merger of Confluence Rivers, Hillcrest Utility Operating Company, Elm Hills Utility Operating Company, Osage Utility Operating Company (Elm Hills), Raccoon Creek Utility Operating Company (Racoon Creek), and Indian Hills Utility Operating Company, Inc. (Indian Hills), with Confluence Rivers as the surviving company. That merger was completed January 1, 2022.[8]

4. Prior to December 31, 2021, the service areas included in this rate case were divided among the six separate operating entities.[9]

5. The Office of the Public Counsel (OPC) is a party to this case pursuant to Section 386.710(2), RSMo (2016) and by Commission Rule 20 CSR 4240-2.010(10).

[5] *Order Approving Agreements*, issued September 27.
[6] Ex. 4, Cox Direct, p. 4.
[7] Ex. 106, Roos Direct, p. 2; and Ex. 6, Cox Rebuttal Schedule JMC-R-4.
[8] Ex. 4, Cox Direct, p. 18, citing File No. WM-2021-0412.
[9] Ex. 17, Thies Direct, p. 17.

6. The Staff of the Commission (Staff) is a party to this case pursuant to Commission Rule 20 CSR 4240-2.010(10).

7. The parties presented six issues for determination by the Commission, listed below:

a. Income Taxes;
b. Acquisition Costs;
c. Timesheets;
d. Cost of Capital;
e. Advanced Meter Infrastructure;
f. Disallowance based on third-party contract operators.[10]

General Conclusions of Law

A. Confluence Rivers is a public utility, sewer corporation, and water corporation as those terms are defined in Section 386.020, RSMo (Supp. 2023).[11] By the terms of the statute, Confluence Rivers is a water and sewer corporation and is subject to regulation by the Commission pursuant to Chapters 386 and 393, RSMo.

B. The Commission's subject matter jurisdiction over Confluence Rivers' rate increase requests is established under Section 393.150, RSMo.

C. Confluence Rivers can charge only those amounts set forth in its tariffs.[12]

D. Subsection 393.140(11), RSMo, gives the Commission authority to regulate the rates Confluence Rivers may charge customers for water and sewer service.

E. Utilities are required to provide safe and adequate service.[13]

[10] Order of Witnesses, filed August 30, 2022.
[11] All statutory references are to the 2016 edition, unless otherwise noted.
[12] Sections 393.130 and 393.140, RSMo.
[13] Sections 393.130 and 393.140, RSMo.

F. In determining the rates Confluence Rivers may charge its customers, the Commission is required to determine whether the proposed rates are just and reasonable.[14]

G. Confluence Rivers has the burden of proving the proposed rates are just and reasonable, pursuant to Section 393.150.2, RSMo, "[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 . . . water corporation or sewer corporation . . ."

H. In order to carry its burden of proof, Confluence Rivers must meet the preponderance of the evidence standard.[15] In order to meet this standard, the Company must convince the Commission it is "more likely than not" that the proposed rate increases are just and reasonable.[16]

I. Witness credibility is solely a matter for the fact-finder, "which is free to believe none, part, or all of the testimony."[17]

J. An administrative agency, as fact finder, also receives deference when choosing between conflicting evidence.[18]

K. The Commission's interpretation of statutes within its purview are entitled to great weight.[19]

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[14] Section 393.150.2, RSMo.

[15] *Bonney v. Environmental Engineering, Inc.*, 224 S.W.3d 109, 120 (Mo. App. 2007); *State ex rel. Amrine v. Roper*, 102 S.W.3d 541, 548 (Mo. banc 2003); *Rodriguez v. Suzuki Motor Corp.*, 936 S.W.2d 104, 110 (Mo. banc 1996), citing to, *Addington v. Texas*, 441 U.S. 418, 423, 99 S.Ct. 1804, 1808, 60 L.Ed.2d 323, 329 (1979).

[16] *Holt v. Director of Revenue, State of Mo.*, 3 S.W.3d 427, 430 (Mo. App. 1999); *McNear v. Rhoades*, 992 S.W.2d 877, 885 (Mo. App. 1999); *Rodriguez v. Suzuki Motor Corp.*, 936 S.W.2d 104, 109-111 (Mo. banc 1996); *Wollen v. DePaul Health Center*, 828 S.W.2d 681, 685 (Mo. banc 1992).

[17] *State ex rel. Public Counsel v. Missouri Public Service Comm'n*, 289 S.W.3d 240, 247 (Mo. App. 2009).

[18] *State ex rel. Missouri Office of Public Counsel v. Public Service Comm'n of State*, 293 S.W.3d 63, 80 (Mo. App. 2009).

[19] *State ex rel. Sprint Mo., Inc. v. Pub. Serv. Comm'n of State*, 165 S.W.3d 160, 164 (Mo. banc 2005) (citing *Foremost–McKesson, Inc. v. Davis*, 488 S.W.2d 193, 197 (Mo. banc 1972)).

INCOME TAXES

Findings of Fact Regarding Income Taxes

Net operating losses

8. Confluence Rivers' entities elected not to claim accelerated depreciation for federal income tax purposes. Therefore the net operating loss balance does not reflect deferred taxes attributable to accelerated depreciation, and normalization rules of the Internal Revenue Code (IRC) do not apply.[20]

9. Income tax expense, for ratemaking purposes, is a hypothetical construct whereby rate base is multiplied by the authorized rate of return and then the statutory tax rate is applied to determine income tax expense.[21]

10. A net operating loss occurs for income tax purposes when a utility's revenues are not enough to cover its expenses.[22] Stated another way, a net operating loss results when a utility does not have enough taxable income to utilize all the tax deductions to which it would otherwise be entitled.[23]

11. If a company has taxable income, a net operating loss from a prior year can be used to offset taxable income, thus the company's taxes due will be reduced. If the net operating loss is greater than the taxable income and can be used to offset all of the taxable income the company will not have to pay income taxes for that year.[24]

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[20] Ex. 16, Seltzer Rebuttal, p. 4.
[21] Ex. 16, Seltzer Rebuttal, p. 7.
[22] Tr. Vol. 9, p. 215.
[23] Ex. 123, Bolin Surrebuttal, p. 1.
[24] Ex. 101, Bolin Direct, p. 4.

12. Confluence Rivers will have a cumulative, or carryover, net operating loss of approximately $9 million as of the likely effective date of new rates in this rate case, November 20.[25]

13. The Tax Cuts and Jobs Act limits the net operating losses generated after January 1, 2018 to an 80% offset. A taxpayer will only be able to utilize 80% of the net operating losses to offset taxable income. Net operating losses generated prior to January 1, 2018, are not subject to the 80% limitation and can be deducted at 100%.[26]

14. Confluence Rivers' net operating loss is expected to exist for an estimated six years.[27]

15. No recovery of net operating losses in rates is being sought by Confluence Rivers in this rate case.[28]

16. There is a prohibition on retroactive ratemaking in Missouri.[29]

17. Confluence Rivers' net operating losses are not the result of timing differences. Tax timing differences occur when the timing used in reflecting a cost (or revenue) for financial reporting purposes (book purposes) is different from the timing required by the Internal Revenue Service (IRS) in determining taxable income (tax purposes).[30]

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[25] Tr. Vol. 9, p. 38 (designating the amount as non-confidential), p. 52, and pp. 54-55. *See also* Ex. 101, Bolin Direct, pp. 3-4.
[26] Ex. 101, Bolin Direct, p. 5.
[27] Tr. Vol. 9, p. 160.
[28] Tr. Vol. 10, p. 62.
[29] Tr. Vol. 9, p. 98.
[30] Ex. 123, Bolin Surrebuttal, p. 2.

18. When a company uses accelerated depreciation, net operating losses are used to offset the money collected from customers recorded as Accumulated Deferred Income Taxes (ADIT).[31]

19. OPC considers the taxes applicable to the difference between accelerated depreciation expense used for income tax purposes and straight line depreciation expense used for ratemaking to be a loan which supports the ADIT reduction to rate base.[32]

20. Utility customers benefit up front when shareholders pay the utility's excess operating expenses which are not recovered through rates, and which result in the net operating losses for income tax purposes.[33]

21. The income tax expense included in this case is to pay future income taxes on Confluence Rivers' taxable income.[34]

22. Retroactive ratemaking would be an effort to include in present rates past expenses that were not included in rates earlier.[35]

Income tax collection

23. The issue at hand is that the Company could collect more income tax expense in rates than it actually remits to the IRS for a time.[36]

24. Confluence Rivers argues that ratemaking treatment for income taxes allows income taxes to be calculated based on the return granted in this rate case whether

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[31] Tr. Vol. 9, p. 158.
[32] Tr. Vol. 9, p. 220.
[33] Tr. Vol. 9, pp. 64-65.
[34] Tr. Vol. 9, p. 121.
[35] Tr. Vol. 9, p. 213.
[36] Tr. Vol. 9, p. 82.

that amount is ultimately remitted to the IRS or not. This is consistent with the ratemaking treatment Staff has used for Confluence Rivers in past rate cases.[37]

25. In past rate cases dealing with Confluence Rivers or its affiliates, Staff did not recommend offsetting income tax expense with net operating loss amounts. Staff did include the net operating loss in this case due to its relative size, $9 million.[38]

26. While taking each utility rate case where a net operating loss exists on its own merit – Staff agreed that the threshhold of inclusion or exclusion of the net operating loss in determination of the income tax expense to include in the revenue requirement would be an arbitrary number.[39]

27. It is the practice of Staff to include the amount necessary to pay income taxes when calculating rates for all utilities.[40] Previously in Confluence Rivers' rate cases, Staff included income tax as part of the revenue requirement even when net operating losses existed.[41]

28. Staff differentiated the treatment of net operating losses in Confluence Rivers' prior rate cases, to the extent they included a net operating loss. Staff may have included a net operating loss for a variety of reasons unrelated to following a preset policy on net operating losses – such as the type of case being a Staff-assisted rate case where the Staff did the bulk of the workload and the timeframe was shorter.[42]

[37] Tr. Vol. 9, p. 88.
[38] Tr. Vol. 9, p. 145.
[39] Tr. Vol. 9, pp. 171-172.
[40] Tr. Vol. 9, p. 119.
[41] Tr. Vol. 9, pp. 129-130.
[42] Tr. Vol. 9, p. 175.

29. Confluence Rivers adopted the rates of the water and wastewater utilities when it acquired those utilities' assets. The increased operating costs, over and above those reflected in those adopted rates, were borne by Confluence Rivers.[43]

30. Many of the utility systems acquired by Confluence Rivers have not increased rates in decades. As a result, the rates did not keep up with increases in operating costs and the need to reinvest in system assets.[44]

31. The net operating losses were the result of having more deductible expenses than revenues for income tax purposes.[45]

32. Upon acquisition, Confluence Rivers initiated a $1.84 million upgrade of the Indian Hills water system.[46]

33. The 2019 Indian Hills federal income tax return indicates that deductible expenses exceeded revenues resulting in a net operating loss carryforward.[47]

34. The Commission's Report and Order in Indian Hills' rate case, File No. WR-2017-0259, included a rate base of $663,596 and a return of 9.375%. The revenue requirement therefore included earnings of approximately $62,212 ($663,596 x 9.375%) to be included in annual revenues.[48]

35. Staff offered an alternative to including the net operating losses in the calculation of income tax expense that would track the difference between what is actually paid in taxes and what is billed as income tax expense in rates.[49]

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[43] Ex. 16, Seltzer Rebuttal, pp. 8-9.
[44] Ex. 19, Thies Surrebuttal, p. 9.
[45] Tr. Vol. 9, p. 147.
[46] Ex. 4, Cox Direct, p. 11.
[47] Ex. 222C, Indian Hills' tax return, p. 9.
[48] Ex. 225, Indian Hills Report and Order from WR-2017-0259.
[49] Tr. Vol. 9, pp. 116-117.

36. For a certain period of time the income tax expense included in rates set in this case will provide a cash benefit to Confluence Rivers because for tax purposes it will be able to reduce its taxable income by its net operating loss carryforwards.[50]

37. Absent the net operating losses, OPC would include income tax expense in Confluence's rates.[51]

38. OPC witness Riley acknowledged that if the Commission sets the income tax to include the net operating loss, when income taxes come due the Company will need to seek a general rate increase via a rate case in order to include its income taxes in its revenue requirement.[52]

Conclusions of Law Regarding Income Taxes

M. All water and sewer utilities under the jurisdiction of the Commission are required by 20 CSR 4240-50.020 (1) and 20 CSR 4240-61.020 (1) to follow the Uniform System of Accounts (USoA) for their designated class. The following accounts are designated for Accumulated Deferred Income Taxes and are applicable to Confluence Rivers.

281. Accumulated Deferred Income Taxes-Accelerated Amortization.

> A. This account shall be credited and account 410, Provision for Deferred Income Taxes, shall be debited with an amount equal to that by which taxes on income payable for the year are lower because of accelerated (5·year) amortization of (1) certified defense facilities in computing such taxes as permitted by Section 168 of the Internal Revenue Code of 1954 and (2) certified pollution control facilities in computing such taxes as permitted by Section 169 of the Internal Revenue Code of 1954 as compared to the depreciation deduction otherwise appropriate and allowable for tax purposes according to the straight line or other nonaccelerated depreciation method and appropriate estimated useful life for such property.

[50] Tr. Vol. 9, p. 121.
[51] Tr. Vol. 9, p. 220.
[52] Tr. Vol. 9, pp. 219-220.

B. This account shall be debited and account 411, Income Taxes Deferred in Prior Years - Credit shall be credited with an amount equal to that by which taxes on income payable for the year are greater because of the use in prior years· of accelerated instead of nonaccelerated or nonliberalized depreciation resulting in the deferral of taxes in such prior years as described in paragraph A above. Such debit to this account and credit to account 411 shall in general represent the effect on taxes payable for the current year of the unavailability or reduced amount of a depreciation deduction for tax purposes with respect to any depreciable property for which accelerated amortization was used in prior years as compared to the depreciation deduction otherwise available and appropriate for such property considering its estimated useful life according to the depreciation method ordinarily used by the utility for similar property in computing depreciation for tax purposes by a nonaccelerated or nonliberalized depreciation method.

C. Records with respect to entries to this account as described above and the account balance shall be so maintained as to show the factors of calculation and the separate amounts applicable to the facilities of each certification or amortization tor tax purposes.

282. Accumulated Deferred Income Taxes-Liberalized Depreciation.

A. This account shall be credited and account 410. Provision for Deferred Income Taxes shall be debited with an amount equal to that by which taxes on income payable for the year are lower because of the use of liberalized depreciation in computing such taxes as permitted by Section 167 of the Internal Revenue Code of 1954, as compared to the depreciation deduction otherwise appropriate and allowable for tax purposes for similar property for the same estimated useful life according to the straight line or other nonliberalized method of depreciation.

B. This account shall be debited and account 4ll, Income Taxes Deferred in Prior Years - Credit shall be credited with an amount equal to that by which taxes on income payable for the year are greater because of the use in prior years of liberalized depreciation for income tax purposes and deferral of taxes in such prior years as described in paragraph A above. Such debit to this account and credit to account 411, shall in general represent the effect on taxes payable for the current year of the smaller amount of depreciation permitted for tax purposes for the current year with respect to any depreciable property for which liberalized depreciation was used in prior years, as compared to the depreciation deduction otherwise appropriate and available for similar property of the same estimated" useful life according to the straight line or other nonliberalized depreciation method ordinarily used by the utility in computing depreciation for tax purposes.

C. Records with respect to entries to this account, as described above and the account balance shall be so maintained as to show the factors of calculation and the separate amounts applicable to the plant additions of each vintage year for each class, group, or unit as to which different liberalized depreciation methods and estimated useful lives have been used. The underlying calculations to segregate and associate deferred tax amounts with the respective vintage years may be based on reasonable methods of approximation if necessary consistently applied.

Account 283. Accumulated Deferred Income Taxes - Other.

A. This account, when its use has been authorized by the Commission for specific types of tax deferrals shall be credited and account 410. Provision for Deferred Income Taxes, shall be debited with an amount equal to that by which taxes on income payable for the year are lower because of the current use of deductions' other than accelerated amortization or liberalized depreciation in the computation of income taxes, which deductions for general accounting purposes will not be fully reflected in the utility's determination of annual net income until subsequent years.[53]

N. Courts have described the retroactive ratemaking doctrine as follows:

> Section 393.140(11) provides that “[n]o corporation shall charge, demand, collect or receive a greater or less or different compensation for any service rendered or to be rendered than the rates and charges applicable to such services as specified in its schedules filed and in effect at the time.” “The filed rate doctrine ... precludes a regulated utility from collecting any rates other than those properly filed with the appropriate regulatory agency.” “This aspect of the filed rate doctrine constitutes a rule against retroactive ratemaking or retroactive rate alteration.” Retroactive rate-making is defined as “the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established.”[54]

[53] National Association of Regulatory Utility Commissioners (“NARUC”) Uniform System of Accounts for Class A & B Water (1973) and Wastewater (1976).

[54] State ex rel AG Processing v Public Service Comn, 340 S.W.3d 146, 150 (2011), quoting State ex rel. AG Processing, Inc. v. Public Service Com’n, 311 S.W.3d 361, which cited *State ex rel. Util. Consumers' Council of Mo., Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 59 (Mo. banc 1979).

Issues Presented by the Parties

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?*

Decision Regarding Income Tax

The Commission finds that setting an income tax expense without consideration of Confluence Rivers' net operating loss carryforward balance is appropriate in this circumstance. Income tax expense, a hypothetical construct used in ratemaking, is the result of multiplying the rate base by the Commission authorized rate of return and then the statutory tax rate. This provides the utility recovery of the income tax expense associated with its authorized return on its investment.

Staff in prior Confluence Rivers' rate cases has consistently applied this methodology for income tax expense. This is the only income tax expense included in rates and there is no component within that methodology that considers the actual revenues or deductions reported on federal or state income tax returns. Confluence Rivers proposed no alternative treatment of income taxes for this case.

Staff in this case is asking the Commission to apply a different methodology, to offset income tax expense included in the revenue requirement by net operating losses recognized by Confluence Rivers for income tax purposes from past years. The result of Staff's proposed methodology would be to eliminate income tax expense from Confluence Rivers' revenue requirement.

Historically, ratemaking has only considered net operating losses in the context of ADIT. ADIT generally results from the use of accelerated depreciation for income tax purposes and the requirement that straight line depreciation be used for ratemaking. This results in a depreciation expense deduction for tax purposes typically higher than what is included in utility rates. Therefore, actual income tax expense is reduced below the amount recovered in rates.

The IRC requires the normalization of depreciation expense and the use of straight line depreciation for utility regulatory ratemaking when accelerated depreciation is used for income tax purposes. Accelerated depreciation allows earlier recognition of depreciation expense than straight line depreciation. Both depreciation methods result in a plant value of zero at the end of its useful life. The cumulative amount of income taxes paid over time compared to the income taxes included in rates demonstrates that customers are typically contributing moneys above what is being paid for income taxes. This difference between income taxes actually paid and income tax expense included in utility rates is quantified as ADIT.

The Commission has typically authorized that the ADIT balance be deducted from rate base to eliminate a return on customer moneys above what is actually being paid for income taxes.

A net operating loss results when, for income tax purposes, allowable expense deductions exceed revenues, eliminating taxable income. The IRC currently allows net operating losses to be carried forward to be used in future years to offset revenues and reduce taxable income by up to 80%.

The Commission has authorized a specific treatment of net operating losses to offset the ADIT reduction to rate base, considering that when a net operating loss occurs the entire accelerated depreciation expense deduction was likely not realized for income tax purposes. There is no evidence in the record to indicate the Commission has authorized any other treatment of net operating losses for ratemaking.

Confluence Rivers has not used accelerated depreciation for income tax purposes and has not indicated that it has any ADIT accounts with balances. For NARUC USoA class A and B water and sewer companies in Missouri, accounts 281-283 are used to record ADIT.

The allowable expense deductions of the Company exceeded revenues for income tax purposes in the prior years that the Confluence Rivers net operating losses were generated. Rates in those prior years did not generate enough revenues to cover operating expenses. The Confluence Rivers net operating losses were not the result of accelerated depreciation allowing for ADIT treatment or the net operating losses being used to offset ADIT.

Net operating losses are a function of income taxes created by the federal government to allow future recovery of current recognized excess deductible expenses through the reduction of future income taxes.

Confluence Rivers has purchased many water and sewer utilities in Missouri while leaving the existing utility rates in place. Some utility systems purchased by Confluence Rivers have not had rate increases for many years. Confluence Rivers has made capital improvements through investments and has maintained the utility system operations while actual costs have exceeded revenues generated by the existing rates.

Rate cases allow for recovery of earnings on plant investments and the current costs to provide services through utility rates. Theoretically, only earnings create taxable income because rates provide recovery of all expenses. Revenues less expenses equals taxable income. When there is no taxable income there are no earnings. When expenses exceed revenues, net operating losses are recognized equal to the excess expense amount. The existence of net operating losses indicates that Confluence Rivers has paid for expenses it did not recover from customer revenues.

Indian Hills is an example of where rates set in February 2018 included earnings on rate base. A review of Indian Hills' 2019 federal income tax return, after those rates had been in effect for a full calendar year indicated that deductible expenses exceeded revenues resulting in a net operating loss. Confluence Rivers did not earn a return on its investment in Indian Hills in 2019.

Reaching back to include actual revenues or expenses in prior years for determining expenses in the current rate case would be retroactive ratemaking. The Confluence Rivers expense deductions of prior calendar year tax returns that resulted in the net operating losses will never be recovered in rates because of the prohibition on retroactive ratemaking.

Without accelerated depreciation, Confluence Rivers has no ADIT or income tax timing difference for ratemaking. Timing differences allow for the deferral of income tax expense that will reverse over time. With ADIT, the timing difference for depreciation expense recognition reverses over time. No evidence has been presented of the Commission's consideration of net operating losses in setting rates outside of ADIT rate base treatment.

Staff's alternative proposal is to recognize the difference between actual income tax paid in future years and income tax expense included in rates. The excess income tax expense included in rates would be deducted from rate base, similar to the treatment of ADIT. Net operating losses created during years where Confluence Rivers received no earnings and paid for expenses it did not recover from customer revenues would be used to reduce actual income tax paid in future years. On its face this would appear to be unequitable in addition to being retroactive ratemaking. No evidence of the impact of higher or lower revenues on income tax paid was offered even though this would be a fundamental component of the taxable income tax equation. Any variation from expense levels included in rates could also impact the amount of income taxes paid although this was not addressed in testimony or any evidence provided.

For the above reasons, income tax expense for the revenue requirement should be calculated in this rate case consistent with the methodology used by Staff in prior Confluence Rivers' rate cases. Confluence Rivers is directed to calculate income tax expense by multiplying the rate base by the Commission authorized rate of return and then the statutory tax rate.

Further, the Commission does not find it appropriate given the facts in this case to defer or make an offset to rate base of the difference between actual income taxes paid in the future by Confluence Rivers and the income tax expense recovered through rates, and no such deferral or offset will be authorized.

ACQUISITION COSTS

Findings of Fact Regarding Acquisition Costs

The Costs

39. As a business model, Confluence Rivers, via CSWR, purchases systems that are distressed.[55]

40. The initial contract signed by Confluence Rivers and the utility system owner is not the final purchase agreement that transfers title. Acquisition costs can be, and in this case were, incurred extensively after the initial contract is signed.[56]

[55] Ex. 19. Thies Surrebuttal, p. 8.
[56] Tr. Vol. 9.5, pp.40-42.

41. Submitted acquisition costs in this case include expenditures that allowed the Company to determine the feasibility of capital improvements that will need to be made to the systems. They also included the legal and other costs associated with securing clean title to the property, confirming proper easement access to the system components, and the costs to appropriately file required acquisition documentation with the Commission.[57]

42. Confluence Rivers recorded acquisition-related costs to various plant-in-service accounts.[58]

43. Once a particular utility system acquisition has been completed, it is Confluence Rivers' procedure to transfer amounts recorded in Preliminary Survey and Investigation Charges (account 183) to Construction Work in Progress (account 107), and ultimately to a utility plant in service account, for inclusion in rate base. In its filing, the Company had recorded $1,218,969 of these acquisition-related expenditures in Utility Plant in Service accounts.[59]

44. Confluence Rivers water systems have acquisition costs ultimately posted to 1973 NARUC USoA Class A and B account 343-Transmission and Distribution Mains. Sewer systems have acquisition costs ultimately posted to 1976 NARUC USoA Class A and B accounts 352.1-Collection Sewer-Force and 352.2-Collection Sewers-Gravity.[60]

45. Confluence Rivers argues that the acquisition costs were handled according to the accounting instructions laid out in the NARUC USoA. Confluence Rivers

[57] Ex. 18, Thies Rebuttal, p. 10.
[58] Ex.110, Majors Direct, p. 14.
[59] Ex. 18, Thies Rebuttal, p.11.
[60] Ex. 23, DR 66.

included a partial definition of account 183-Preliminary Survey and Investigation Charges, in its testimony:

> This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc. made for the purpose of determining the feasibility of project under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged.[61]

46. Confluence Rivers' testimony omitted portions of the NARUC USoA description of account 183-Preliminary Survey and Investigation Charges. Part B of the account description states:

> The records supporting the entries to this account shall be so kept that the utility can furnish complete information as to the nature and the purpose of the survey, plans, or investigations and the nature and amounts of the several charges.
>
> Note. - The amount of preliminary survey and investigation charges transferred to utility plant shall not exceed the expenditures which may reasonably be determined to contribute directly and immediately and without duplication to utility plant.[62]

47. In prefiled testimony filed June 29, 2023, the Company references an amount of $1,218,969 in acquisition costs.[63]

48. Staff categorized the acquisition costs identified. The acquisition costs categorized by Staff were $987,852 and the break-down is as follows:

a. Engineering-Admin - $208,525;

b. Engineering-GIS[64] - $59,828;

c. Engineering-Survey - $166,353;

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[61] Ex. 18, Thies Rebuttal, p. 10.
[62] National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts for Class A & B Water (1973) and Wastewater (1976).
[63] Ex. 18, Thies Rebuttal, p. 11.
[64] Geographic Information System.

d. Legal-Real Estate - $430,667;

e. Legal-Regulatory - $114,272;

f. No description - $8,207.[65]

49. Staff's acquisition cost adjustment would reduce rate base and the return included in the revenue requirement. Staff's adjustment is not to expenses.[66]

50. Staff recommended a disallowance of $987,852 in acquisition costs from Confluence Rivers' plant accounts.[67]

System Conditions When Acquired

51. In Confluence Rivers' acquisition of Missouri water and sewer systems, 68 of them were out of compliance with the Missouri Department of Natural Resources (DNR) when purchased.[68]

52. Many of the systems Confluence Rivers purchased were done so at the request of DNR and most of those required emergency operations.[69]

53. Confluence Rivers has closed on a property with a contested access to the plant.[70]

54. If the seller does not own all of the assets they claim to own, Confluence Rivers goes through the process of obtaining titles, which includes going through the real property records, and surveys to determine where the assets really lay.[71]

Past Commission Treatment of Acquisition Costs

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[65] Ex. 221, DR 66 work papers.
[66] Tr. 9.5, p. 44.
[67] Tr. Vol. 9.5, pp. 64-66.
[68] Tr. Vol. 9.5, p. 28.
[69] Tr. Vol. 9.5, pp. 29.
[70] Tr. Vol. 9.5, p. 29.
[71] Tr. Vol. 9.5, p. 42.

55. As a general rule, only the original cost of utility plant to the first owner devoting the property to public service, adjusted for accumulated depreciation, should be included in the utility's rate base.[72] This protects against unreasonable returns by not providing rate base treatment on investments that are above net depreciated original costs at the time of purchase. This concept is the net original cost rule.[73] 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. Generally, costs which do not benefit the ratepayer are considered costs of ownership and are not recoverable from customers.[74]

56. Staff based its recommendation on the Commission's past treatment of acquisition costs in two cases, citing the Great Plains Energy Incorporated, Kansas City Power & Light Company and Aquila, Inc. merger File No. EM-2007-0374, which discussed transition and transaction costs.[75]

57. The second cited prior decision was File No. EM-2000-292, which discussed transition and transaction costs involved two large, regulated, electric utilities, Saint Joseph Light & Power and UtiliCorp United, Inc.[76]

58. Transaction costs are costs incurred by the purchaser and seller to effectuate the financial, legal, and regulatory requirements of the merger. These costs are incurred prior to and immediately after a merger or acquisition.[77]

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[72] Ex. 129, Majors Surrebuttal, p. 7, citing File No. EM-2000-292, Second Report and Order, *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*, 12 Mo.P.S.C.3d 388, 389-90 (2004), effective March 7, 2004.
[73] Ex. 129, Majors Surrebuttal, p. 6.
[74] Ex. 129, Majors Surrebuttal, p. 6, citing to the Report and Order in Case No. EM-2007-0374.
[75] Tr. Vol. 9.5, p. 90 and p. 75.
[76] Tr. Vol. 9.5, p. 75.
[77] Ex. 110, Majors Direct, p. 14.

59. Transition costs are costs incurred to combine the entities participating in the acquisition to combine the operations and are incurred as the operations of the merged or acquired entities are combined.[78] These transition costs may later be amortized and recovered through rates.[79]

60. Synergy savings are reductions in costs from combining the operations of merging utilities as compared to the combined costs of the entities standing alone. Examples of synergy savings include benefits of scale, improved efficiency in support functions, economies of scale in purchasing, and savings from combining customer service and field operations in the same geographic area.[80]

61. Staff's witness indicated that Confluence Rivers' purchase of small utility systems does not create the traditional synergies that might offset acquisition costs.[81]

62. Regarding prior Confluence Rivers' cases, some deferred maintenance costs for leak repairs, line location, smoke testing, and sludge removal for the Indian Hills, Elm Hills, and Raccoon Creek systems have been deferred and amortized. While Confluence Rivers considers those costs to be similar to the acquisition costs in the current case, the treatment of those costs in the prior rate cases were specifically agreed to in disposition agreements.[82]

63. A disposition of a small utility company revenue increase request does not support any specific party's positions. There were no agreements between the parties when prior Confluence Rivers' rate cases were settled that specified, if or which acquisition costs would or would not be included in rate base.[83]

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[78] Ex. 110, Majors Direct, p. 14.
[79] Tr. Vol. 9.5, p. 71.
[80] Ex. 129, Majors Surrebuttal, pp. 4-5.
[81] Tr. Vol. 9.5, pp. 85-86.
[82] Ex. 129, Majors Surrebuttal, p. 8.
[83] Tr. Vol. 9.5, pp. 61-62.

64. Confluence Rivers argued that the acquisition costs identified as engineering and legal are indirect capital costs, and the NARUC USoA instructs the capitalization of the indirect costs with the transmission or collection systems that are the more direct costs, such as actual pipe in the ground.[84]

65. Acquisition costs posted to transmission and collection plant accounts would have a return or profit on the dollars if included in the revenue requirement even though no additional pipe was installed.[85]

66. Confluence Rivers argued that workpapers in the Company's prior Staff-assisted rate cases (File Nos. WR-2020-0053 and WR-2020-0275) show that some acquisition costs have previously been allowed and included with rate base. The Company also argued there were no disallowances of acquisition costs in other rate cases filed by predecessor companies Hillcrest (WR-2016-0064 and SR-2016-0065), Raccoon Creek (SR-2016-0202) and Indian Hills (WR-2017-0259).[86]

67. Staff acknowledged that it has included some acquisition costs as rate base in prior Confluence Rivers-related Staff-assisted rate cases.[87]

68. Treating the engineering and legal costs as plant items would capitalize the cost to a specific asset, some of which can have a fifty-year life span.[88]

Engineering Costs-Admin, GIS, and Survey

69. Confluence Rivers testified it has a low percentage of transaction costs as all of work prior to a contract being signed is done in-house.[89]

[84] Tr. Vol. 9.5, p. 19.
[85] Tr. Vol. 9.5, p. 22.
[86] Ex. 18, Thies Rebuttal, p. 12.
[87] Tr. Vol. 9.5, p. 70, and p. 74.
[88] Tr. Vol. 9.5, p. 71.
[89] Tr. Vol. 9.5, p. 39.

70. After the contract is signed, Confluence Rivers begins to incur engineering and legal costs to be ready for closing, which includes: mapping of the system (GIS); determining all of the assets; and verifying legal ownership and access of all of the assets.[90]

71. Some of the preliminary expenditures of Confluence Rivers were intended to determine the extent and scope of the condition of the systems and the needed repairs.[91]

72. Flinn Engineering was one of the vendors providing services categorized by Confluence Rivers under Engineering – Admin as part of the acquisition costs.[92] The purpose of the Flinn Engineering report was listed as valuation.[93]

73. Feasibility studies to evaluate potential projects related to the evaluation of a potential acquisition are not eligible for capitalization.[94]

74. For Confluence Rivers, if the seller does not own all the assets it claims to own; the transaction is put on hold as Confluence Rivers goes through the process of getting title, which includes going through real estate records, performing surveys and determining where the assets really exists.[95] Confluence Rivers needs asset location data for Missouri One Call.[96]

75. Any costs to secure clean title to the property are costs of ownership.[97]

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[90] Tr. Vol. 9.5, pp. 9, and 41.
[91] Ex. 18, Thies Rebuttal, pp. 11-12.
[92] Ex. 221, DR 66 work papers, p. 2.
[93] Ex. 23, DR 66, p. 103
[94] Ex. 129, Majors Surrebuttal, p. 5.
[95] Tr. Vol. 9.5, p. 42.
[96] Tr. Vol. 9.5, pp. 27-28.
[97] Ex. 129, Majors Surrebuttal, p. 5.

76. Staff acknowledged that the GIS costs have merit to be recovered, but recommended recovery as amortized expenses.[98] Staff cited its belief that certain of the acquisition costs were incurred for the betterment of the entire system and for customers.[99]

77. Other expenditures included costs to determine proper title and sufficient easement and right of way access to properties or to obtain Commission approval of the transaction.[100]

Legal Costs-Real Estate, and Regulatory

78. The Legal-Real Estate costs, according to Staff's witness, are to some extent costs to acquire title and to establish right-of-way easements when property is transferred. Confluence Rivers indicated that the Legal-Real Estate costs are also required to establish who owns the property and where the assets actually are.[101]

79. The Company's costs to pay a lawyer to draft the contract for an acquisition are not included in the costs identified as acquisition costs in this rate case.[102]

80. There are utility systems acquired by the Company where previous owners did not have easements or otherwise did not have legal access to the utility systems' assets. Generally, Confluence Rivers would resolve these issues before closing on the purchase of the utility system.[103]

[98] Tr. Vol. 9.5, p. 93.
[99] Tr. Vol. 9.5, p. 92.
[100] Ex. 18, Thies Rebuttal, pp. 11-12.
[101] Tr. Vol. 9.5, pp. 68-69.
[102] Tr. Vol. 9.5, p. 21.
[103] Tr. Vol. 9.5, p. 29.

81. There is a benefit to the utility system and its customers in the future for establishing clear title to the utility system assets and obtaining easements for access to the utility system assets.[104]

82. Acquisition cost vendors identified as Legal-Regulatory include Brydon, Swearengen & England, P.C., ScottMadden, Inc., and Nitor Billing Services, LLC.[105]

83. Confluence Rivers' witness D'Ascendis is a partner at ScottMadden, Inc.[106]

84. Confluence Rivers' application in this case and representation in part has been provided by Dean L. Cooper, of Brydon, Swearengen & England, P.C.[107]

85. Nitor Billing Services, LLC has previously provided customer billing services, and currently provides call center services for Confluence Rivers.[108]

86. Confluence Rivers has not provided any evidence to support Nitor Billing Services, LLC's role in the acquisition activities prior to closing.[109]

87. Confluence Rivers' response to Staff data request (DR) 66 included documents that identify a number of real estate related costs beyond the purchase price of utility systems. Acquisition costs described by Confluence Rivers as Legal-Real Estate in its general ledger postings include a number of vendors that do not appear in the documents provided in Exhibit No. 23, DR 66. In addition, potential vendors identified in Exhibit No. 23 documents are not included in the general ledger postings identified as acquisition costs.[110]

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104 Tr. Vol. 9.5, pp. 73-74.
105 Exs. 23 and 221.
106 Ex. 7, D'Ascendis Direct, p. 1.
107 Tr. 9.5, p. 2 and EFIS Item No. 2, Transmittal Letter.
108 Ex. 103, Dhority Direct, pp. 3-4.
109 Ex. 23, DR 66; and Ex. 18, Thies Rebuttal, p. 10.
110 Ex. 23, DR 66; and Ex. 221, DR 66 work papers.

88. Specifically, Confluence Rivers is asking that the acquisition costs it has included in various plant accounts earn a return of depreciation expense from anywhere from a 20- to 50-year life span and a return on depreciation expense through the rate base rate of return calculation.[111]

89. Staff recommended a five-year amortization of some of the acquisition costs as an alternative to Confluence Rivers proposed treatment. Staff also recommended that the amortized costs not receive rate base treatment.[112]

Uncategorized Costs

90. There was $8,207 in acquisition costs for which no description was provided. That $8,207 was merely identified as "Transfer In" with no explanation. No evidence was presented to explain what the uncategorized costs covered.[113]

Conclusions of Law Regarding Acquisition Costs

P. Section 393.170, RSMo (Supp. 2022), states, pertinent part:

> 2. No such corporation shall exercise any right or privilege under any franchise hereafter granted … without first having obtained the permission and approval of the commission. …
>
> 3. The commission shall have the power to … determine that such … exercise of the … franchise is necessary or convenient for the public service. The commission may by its order impose such condition or conditions as it may deem reasonable and necessary. …

Issue Presented by the Parties

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

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[111] Tr. Vol. 9.5, p. 91.
[112] Tr. Vol. 9.5, p. 92.
[113] Ex. 23, DR 66; and Ex. 221, DR 66 work papers.

Decision Regarding Acquisition Costs

The only two cases cited by the parties in which the Commission discussed that acquisition costs be designated as transition or transaction costs involved large electric utility corporate entities. The merger of large utility systems also typically create merger synergies or savings that offset transaction and transition costs, which are recovered before the next rate case where operating costs are then determined on a post-merger basis. While the analysis and treatment of transition and transaction costs was useful in those cases and in those circumstances, the Commission finds the analysis of transaction costs identified in this Confluence Rivers rate case and the circumstances to be different enough that it will allow recovery of some of the acquisition costs. No evidence was presented to support Confluence Rivers realizing any merger savings to offset the acquisition costs identified.

However, the Commission will rely on the underlying premise that founded the distinction of transaction versus transition costs – the net original cost rule. The rule states "Generally, transaction costs which do not benefit the ratepayer and are only costs of ownership are not recoverable from customers." Transition costs that facilitate the combination of multiple utility systems in the absence of offsetting synergy opportunities typically benefit customers and would therefore be recoverable through rates. The Commission agrees with Staff that none of the identified acquisition costs in this case are transition costs.

However, the condition of distressed water and sewer utility systems requires consideration of original cost in a somewhat different context emphasizing whether the added costs after the utility property was first devoted to public use create any actual change in the usefulness of the plant. Confluence has demonstrated that at least some distressed water and sewer utility systems are in such condition that the original costs as identified by the original owner's records are inadequate to support viable utility systems. Immediate improvements to bring distressed water and sewer utility systems into DNR compliance and to provide safe and adequate service to customers should be recoverable to some extent. The original costs provide the basis for a return of the original cost through depreciation and the return on the utility system investment through earnings. The Commission's treatment in this rate case will not treat the identified acquisition costs as original plant investment. Providing recovery through an amortization of some of the identified acquisition costs will allow recovery of the identified transaction costs but will not allow a return on the identified acquisition costs. The Commission will allow a specific subset of costs to be capitalized.

The Commission recognizes that there is an approximate difference of $250,000 between the two acquisition cost amounts presented by Confluence Rivers and Staff ($1,218,969 from witness Thies' Rebuttal and $987,852 from DR 66 as aggregated by Staff in Ex. 221). The Commission considered each category of acquisition costs as described and quantified by Staff and presented into evidence as Exhibit No. 221.

Engineering Costs-Admin

Confluence Rivers' witness testified that the engineering feasibility work occurred after a contract is signed and prior to closing. That testimony is controverted by the information contained in Exhibit No. 23, which is DR 66, which indicated that Flinn Engineering was performing valuation services, which the Commission would expect would occur prior to contract signature and would also be a transaction cost, as defined by Staff. There is no evidence to verify the services provided by the other vendors in this category. Therefore, the Commission rejects recovery of the Engineering-Admin acquisition costs of $208,525.

Engineering Costs-GIS

The Commission finds that the costs included in the category of Engineering-GIS fall within the applicability of the net original cost rule because the addition of the GIS mapping of the water and sewer utility systems does change the usefulness of the plant assets for both the utility systems and customers going forward. If these systems transfer ownership in the future, none of the geo-locating should need to be repeated. Staff agreed at hearing that there would be merit in allowing recovery of these costs because of future benefits to customers. The Commission disagrees with Staff's opinion that the GIS costs should be amortized and instead will authorize that the Engineering-GIS costs in the amount of $59,828 be capitalized to earn both a return on and of the costs in rates.

Engineering Costs-Surveys

The Company testified that surveys are used to address title issues as well as prepare for taking over operations. Due to the lack of detailed information submitted by Confluence Rivers, it was not possible for the Commission to delineate surveying services relative to resolving title issues and engineering services to prepare for taking over the operation of the system. Therefore, due to the lack of evidence to indicate the breakdown of surveying, the items contained in the category Engineering-Survey in the amount of $1,195 and $165,158 are not authorized for recovery.

Legal Costs-Regulatory and Real Estate

Evidence supports the costs to acquire the Certificate of Convenience and Necessity (CCN) for each Confluence Rivers utility system included in the acquisition costs identified by Staff. Staff agreed at hearing that similar costs for a rate case proceeding would be recoverable. The Commission will allow recovery of these Legal-Regulatory costs in the amount of $113,244 ($114,272 - $1,028) through a five-year amortization.

The legal costs authorized do not include any amount attributed to Nitor Billing Services ($1,028), as there is no evidence to support a finding that Nitor Billing Services provided (or can provide) legal services.

Evidence provided by Confluence Rivers supported that the Legal-Real Estate costs were incurred to gain clear title to utility system assets and invest in easements for access to utility system property for maintenance of the systems. The inadequate condition of the distressed water and sewer utility systems records required these costs be incurred which under normal conditions would generally be avoided. The legal-real estate costs amount of $430,667 shall be amortized over 5-years.

Uncategorized Costs

The $8,207 in recorded uncategorized acquisition costs lacks evidence to assess if it should be eligible to be included in recoverable acquisition costs. Therefore, the request to recover $8,207 in uncategorized acquisition costs is rejected.

NARUC

Confluence Rivers argued that the NARUC USoA for water and sewer companies contemplates acquisition costs in its description of account 183 – Preliminary Survey and Investigation Charges. The Commission finds this to be incorrect. “The feasibility of projects under contemplation” is for costs of potential projects of a utility already owned and in operation. Confluence Rivers’ interpretation is for projects contemplated prior to ownership to assess what projects would need to be undertaken to bring a utility up to safe and adequate service. In other words, the Company seeks to know how much of an investment beyond the purchase price is required.

Within the USoA, specific account descriptions and general instructions leave room for some interpretation. However, the evidence in this case related to acquisition costs identified by Staff as transaction costs do not support ultimately posting the costs to USoA 343- Water Transmission and Distribution Mains or to USoA 352.1 Collection Sewer-Force or 352.2 Collection Sewer-Gravity. The USoA description of account 183 requires that records be maintained that support a direct relationship between the preliminary cost and the plant project completed and placed into service. No evidence was provided in this case other than for Engineering-GIS related costs to demonstrate that the use of accounts 183, 343 and 352.1 and 352.2 were appropriate for the acquisition costs identified by Staff.

TIMESHEETS

Findings of Fact Regarding Timesheets

91. Confluence Rivers has previously agreed to keep detailed timesheets for all employees.[114]

92. A timesheet helps to insure a cost causation connection between the employees and the utility system that cause costs to be incurred.[115]

93. Confluence Rivers is a subsidiary of CSWR, LLC.[116]

[114] Ex. 107, Sarver Direct, pp. 17-18.
[115] Tr. Vol. 9.5, p. 143.
[116] Ex. 17, Thies Direct, p. 2.

94. Confluence Rivers has no employees. General business services are provided by CSWR, LLC. Other services, such as accounting, meter reading for billing, and customer service functions, are provided by third party vendors.[117]

95. CSWR began maintaining timesheets in January 2021.[118]

96. Confluence Rivers testified it is 92% in compliance with the various orders of the Commission to keep timesheets. Only seven employees have not consistently kept timesheets.[119]

97. Confluence Rivers admitted it did not fully comply with its agreements in regards to the timesheets of certain executives, which the Company suggested was a result of the tremendous growth experienced at CSWR since the time of that commitment.[120]

98. Confluence Rivers' business model included an effort to achieve economies of scale across the entire CSWR national footprint.[121]

99. Confluence Rivers' corporate growth has been rapid, entering six additional states and adding 157 acquisitions (approximately 95,000 connections) since December 31, 2020.[122]

100. Over the past five years, the amount of CSWR corporate overheads allocated to Missouri have decreased as a result of the CSWR's growth.[123]

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[117] Ex. 107, Sarver Direct, pp. 2-3.
[118] Ex. 107, Sarver Direct, pp. 18-19.
[119] Tr. Vol. 9.5, p. 131.
[120] Ex. 5, Cox Rebuttal, p. 32.
[121] Ex. 5, Cox Rebuttal, p. 32.
[122] Ex. 5, Cox Rebuttal, p. 32.
[123] Ex. 5, Cox Rebuttal, pp. 32-33.

101. Confluence Rivers has requested that the need to maintain timesheets be suspended. As an alternative, the Company requested that director-level staff and above would engage in exception time reporting.[124]

102. Exception time reporting is where employees only report their time worked if it varies from a standard, pre-determined value.[125] Under exception time reporting, executive staff's (including director level employees') time would be recorded only when it goes above a standard time allocation.[126]

103. Confluence Rivers' executive staff includes fourteen positions: the President, Vice President, Senior Vice President, Chief Financial Officer, Vice President/Corporate Controller, Chief of Staff, Director of Financial Planning and Analysis, Director of Engineering, Director of Asset Management, Director of Customer Experience, Director of Human Resources, Director of Regulatory Operations, General Counsel and Associate General Counsel.[127]

104. Confluence Rivers also proposed a Project Time-Tracking plan in which its executive staff tracks their time spent on the special projects on a monthly basis.[128]

105. There are certain exceptions and special projects that executive staff could allocate time to on a monthly basis. 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.[129]

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[124] Ex. 5, Cox Rebuttal, pp. 35-36.
[125] Ex. 131, Sarver Surrebuttal, p. 9.
[126] Tr. Vol. 9.5, p. 137.
[127] Ex. 131, Sarver Surrebuttal, p. 9.
[128] Ex. 18, Thies Rebuttal, p. 19.
[129] Ex. 18, Thies Rebuttal, pp.19-20.

106. Confluence Rivers proposes that any time remaining after the project allocations would be allocated using the three-factor methodology that the Company uses for its other overhead allocation costs.[130]

107. The corporate allocation factor is 7.97%.[131]

108. On a daily basis, CSWR's executive staff addresses dozens of issues arising in each of the twelve states in which CSWR is operating a utility system. Confluence Rivers' witness testified that it is extremely time-consuming to keep timesheets.[132]

109. The executive staff employees of CSWR are involved in setting procedures, monitoring operations performance, holding departmental meetings, supervising employees and contractors, and setting strategic direction for the Company. A significant portion of that activity impacts all customers of CSWR's subsidiaries and not just one system or entity.[133]

110. Confluence Rivers argued that executive staff time spent typically affects all subsidiaries, and all customers; thus, it is a cost that should be allocated.[134]

111. Confluence Rivers' system acquisitions are happening so rapidly that timesheet allocations are likely to differ not only year-to-year but quarter-to-quarter. Timesheet entries covering past periods are unlikely to be accurate predictors of how each employee's time should currently be allocated or will be in the future.[135]

[130] Ex. 18, Thies Rebuttal, pp. 19-20.
[131] Ex. 107, Sarver Direct, p. 5; Tr. Vol. 10, p. 183; and Joint Response Regarding Settled Issue, filed September 15, 2023 (filed jointly by all Parties).
[132] Ex. 5, Cox Rebuttal, pp. 35-36.
[133] Ex. 18, Thies Rebuttal, p. 19.
[134] Ex. 18, Thies Rebuttal, p. 19.
[135] Ex. 5, Cox Rebuttal, pp. 31-32.

112. Missouri is the only state that requires CSWR to keep timesheets.[136]

113. Less than 8% of the workload of the CSWR staff during the test year in this rate case was allocated to Missouri.[137]

Conclusions of Law Regarding Timesheets

No additional Conclusions of Law were necessary for this issue.

Issue Presented by the Parties

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

Decision Regarding Timesheets

Both Staff and OPC spent time addressing the prior promises of Confluence Rivers to keep timesheets for all employees. Confluence Rivers admitted it did not fully comply with its agreements in regards to the timesheets of certain executives. However, the only question before the Commission regards ordering timesheets on a going forward basis for employees of CSWR for work performed on behalf of Confluence Rivers, including executives.

The Company argued it should not be ordered to keep timesheets for its executive staff due to the high amount of work involved, the singularity of Missouri's requirement as compared to other states Confluence Rivers has systems in, and the low percentage of Missouri-related work that the employees of CSWR engage in, as Confluence Rivers has no employees of its own. Staff and OPC argue that the timesheets help establish the cost causation connection between the work being done and which utility system. The Commission agrees with both, that timesheets for executives should not be ordered, and

[136] Tr. Vol. 9.5, p. 129, p. 131, and p. 134.
[137] Tr. Vol. 9.5, p. 135.

that establishing cost causation is necessary. The Commission will order that non-executive staff of CSWR continue to keep timesheets. Those timesheets will help establish cost causation.

Confluence Rivers proposed an alternative to timesheets for its executive staff, including directors, Project Time-Tracking. Under the Project Time-Tracking system the non-timesheet keeping staff would record time spent on special projects on a monthly basis. The Commission is not requiring the use of Project Time-Tracking but finds that this additional information collection would likely help alleviate problems Staff raised in determining how to allocate executive staff time to Missouri during future rate case audits. Documentation of appropriate costs for inclusion in a utility's revenue requirement make it easier for the determination of just and reasonable rates.

Regarding executive and director staff, Confluence Rivers is already using a corporate allocation methodology for other items that are shared between utility systems. Parties to Confluence Rivers' rate cases, including Staff, are able to audit allocation factors and determine whether the allocation methodology being applied to shared costs are appropriate. Likewise, using an allocation for executive and director staff time will not preclude the audit of the allocation factors. Applying the corporate allocation factor to executive and director staff time will provide the same cost causation connection as set in this rate case for other shared corporate cost items. The Commission will order the use of the 7.97% corporate allocation factor to also allocate executive and director staff time.

COST OF CAPITAL

Findings of Fact Regarding Cost of Capital

Capital Structure

114. Capital structure represents how a company finances its assets. The typical capital structure consists of common equity, long-term debt, and short-term debt.[138]

115. Generally, the cost of equity will be higher than the cost of debt. It then follows that a capital structure with a higher percentage of equity will result in higher costs to consumers.[139]

116. Confluence Rivers recommended the Commission approve its actual capital structure of 68.56% common equity and 31.44% long-term debt.[140]

117. Staff calculated Confluence Rivers' actual equity at 16.19% as of year-end 2022.[141]

118. OPC calculated Confluence Rivers' actual equity at 16.49% as of year-end 2022.[142]

119. Staff recommended a hypothetical capital structure of 50% common equity and 50% debt due to: Confluence Rivers' proposed equity ratio of 68.56% exceeding Staff's calculation of 16.19% actual equity; the equity ratios of the proxy group; authorized equity ratios of other regulated utilities throughout the country over the last several years; Confluence Rivers' large negative retained earnings balance of approximately $9.5 million

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[138] Ex. 209, Murray Direct, p. 4.
[139] Tr. Vol. 10, pp. 154-155.
[140] Ex. 7, D'Ascendis Direct, p. 15.
[141] Ex. 109, Walters Direct, p. 23.
[142] Ex. 209C, Murray Direct, p. 5. Although marked as confidential in OPC's testimony, the Commission notes that Staff's calculation was not confidential, and thus will publish this number for comparison.

at year-end 2022; its unique corporate structure, which relies directly on affiliates for external capital structure; and Confluence Rivers' size.[143]

120. OPC recommended a capital structure of 45% common equity and 55% long-term debt.[144] OPC argued that the 55% debt is the maximum amount of debt that Confluence Rivers' lender would authorize.[145]

121. Authorized common equity ratios for regulated utilities have generally been in the range of 48.0% to 52.0% over the last several years.[146]

122. The Company testified that generally companies only take capital when it is needed, so as to not be overcapitalized.[147]

123. Prior to the issuance of debt in December 2022, Confluence Rivers operated with no third-party debt.[148]

124. Confluence Rivers borrowed an amount not to exceed $7.2 million in long-term debt from CoBank, ACB (CoBank).[149]

125. Because CoBank's estimate of Confluence's net worth (*i.e.* equity) balance excluded affiliate liabilities (referred to as Holding Company Debt in the definition), CoBank views Confluence Rivers' affiliate payables as equity. This would show Confluence Rivers' equity balance to be approximately 73%.[150] Staff testified that it was

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143 Ex. 214, Walters Direct, p. 25.
144 Ex. 209, Murray Direct, p. 4 and p. 7.
145 Ex. 209, Murray Direct, p. 4.
146 Ex. 109, Walters Direct, p. 24.
147 Tr. Vol. 10, pp. 34-35.
148 Tr. Vol. 10, p. 112.
149 File No. WF-2023-0023, Order Correcting Order Granting Financing Application, issued December 19, 2022.
150 Ex. 209, Murray Direct, p. 6.

unaware of any utility that capitalizes itself at the 80 to 73 percent level, at least on a ratemaking basis.[151]

126. Confluence Rivers' Utility Proxy Group (Utility Proxy Group) is a proxy group of six water companies used by the Company in its calculations.[152]

127. The Utility Proxy Group had an average common equity ratio of 51.78%[153].

128. Staff's proxy group contained 13 companies and included gas utilities. Its average common equity was 46.4% and median common equity was 44.7%.[154]

129. OPC used the Company's Utility Proxy Group.[155]

130. A Confluence Rivers affiliate in Kentucky, Bluegrass Water Utility Operating Company, proposed and was awarded a hypothetical 50/50 capital structure by the Kentucky Public Service Commission.[156]

131. A Confluence Rivers affiliate in Louisiana, Magnolia Utility Operating Company, settled on a hypothetical 60% equity and 40% debt capital structure for two years with an imputed equity cap of 50% for the third year.[157]

132. Generally, business loan covenants are put in place to protect lenders from the risk of the borrower defaulting, not to encourage the borrower to borrow the maximum amount it can.[158]

133. Maintaining a maximum debt ratio would likely be imprudent management of the Company's capital structure, especially given its history of net operating losses.[159]

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[151] Tr. Vol. 10 in camera, p. 107.
[152] Ex. 7, D'Ascendis Direct, p. 4.
[153] Ex. 7, D'Ascendis Direct, pp. 14-15.
[154] Ex. 109, Walters Direct, p. 23, and p. 26.
[155] Ex. 209, Murray Direct, p. 36.
[156] Ex. 109, Walters Direct, p. 24.
[157] Ex. 109, Walters Direct, pp. 24-25.
[158] Ex. 8, D'Ascendis Rebuttal, p. 47.
[159] Ex. 8, D'Ascendis Rebuttal, pp. 47-48.

<u>Conclusions of Law regarding Cost of Capital and Capital Structure</u>

T. In determining the rate of return, the Commission must consider the Company's capital structure and cost of debt, and determine the weighted cost of each component of the utility's capital structure. Determining a Return on Equity (ROE) is imprecise and involves balancing a utility's need to compensate investors against its need to keep prices low for consumers.[160]

U. An accepted practice in utility regulation is to disregard the actual book capital structure of a utility and adopt a hypothetical capital structure for ratemaking purposes when it is deemed to be in the public interest to do so. The Court cited two circumstances: when the utility's actual debt-equity ratio is deemed inefficient and unreasonable because it contains too much equity and not enough debt, necessitating an inflated rate of return; and when the utility is part of a holding company system.[161]

Issues Presented by the Parties:

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

Decision on Capital Structure

Utility service companies are given a monopoly for a service area, and certain items are regulated under the Commission's jurisdiction, pertinent here – customer rates. The capital structure of a business is a factual statement of how it is financed; i.e. the amount of equity and the amount of debt at a given time. Capital structure is used in the calculation of the rate of return, which is applied to rate base and included in customer rates.

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[160] *State ex rel. Pub. Counsel v. Pub. Serv. Comm'n*, 274 S.W.3d 569, 573 (Mo. Ct. App. 2009).
[161] *State ex. Rel. Associated Nat. Gas Co. v. Pub. Serv. Comm'n of Missouri*, 706 S.W.2d 870, 878 (Mo. App., W.D. 1985) internal citations omitted.

Typically, the cost of debt is lower than the cost of equity (ownership), thus there is an incentive for a regulated utility to have a capital structure with a high amount of equity in order to maximize the rate of return formula. In order to protect consumers from utility companies that would try to manipulate its capital structure to take advantage of the higher cost of equity (thus higher return and higher customer rates), the Commission uses, when appropriate, a regulatory or hypothetical capital structure.

In the present case there is no agreement on the capital structure. The Company claimed its actual capital structure is 68.56% common equity with 31.44% long-term debt, and recommended using that capital structure in ratemaking. The Commission finds that the Company's actual debt-equity ratio is inefficient and unreasonable because it contains too much equity and not enough debt.

OPC claimed the actual equity component in the Company's actual capital structure is 16.49%, but recommended a capital structure of 45% equity and 55% long-term debt based on the CoBank loan covenant. Prior to December 2022, Confluence Rivers operated with no third-party debt. The Commission finds that OPC's proposed hypothetical capital structure based on the CoBank loan covenant would likely be imprudent as an actual capital structure. For this reason, the Commission does not find OPC's proposed capital structure to be a reasonable option.

Staff recommended a hypothetical capital structure of 50% common equity and 50% debt due to Confluence Rivers' proposed equity ratio of 68.56% exceeding its own actual equity ratio, the equity ratios of the proxy group, other Commission-authorized capital structures approved throughout the country over the last several years, Confluence's large negative retained earnings balance of approximately $9.5 million at year-end 2022, its unique corporate structure, which relies directly on affiliates for external capital structure and Confluence's size.

The Commission finds that Staff's proposed hypothetical capital structure of 50% equity and 50% debt is appropriate in this case. Ratepayers would benefit from having rates calculated from a 50% debt ratio as debt is a cheaper cost than equity; while the shareholders are benefitting from the rates being calculated from a 50% equity ratio as equity generates a greater return than debt. And each side of the ratemaking calculation, rate payers and shareholders, are protected from the other having a greater share. The Commission finds that a 50/50 capital structure in this case will produce just and reasonable rates.

Cost of Debt

134. Confluence Rivers recommended that the cost of debt be 6.60%, which reflects the cost of debt resulting from a debt issuance approved by the Commission in December 2022.[162] Staff also recommended that the Commission approve Confluence Rivers recommended cost of debt of 6.60%[163]

135. OPC recommended that the appropriate cost of debt to use in calculating Confluence Rivers' rate of return is 6.23%, due to administrative costs and patronage credit that lowers Confluence's effective cost of debt from the actual cost of debt.

136. A patronage credit is a confidential number of basis points, which could be applied each year, but is not guaranteed.[164]

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[162] Ex. 7, D'Ascendis Direct, pp. 2-3.
[163] Ex. 109, Walters Direct, p. 4.
[164] Ex. 209C, Murray Direct, p. 19. The confidential number will not be stated in this order.

137. If the patronage credit is included in the cost of debt and the Company subsequently does not receive a patronage credit, the Company would not be recovering its full cost of debt in its rates for that period of time when no patronage credit was given.[165]

138. OPC requested that if the patronage amount is not included in the cost of debt, that the amount be tracked on a cumulative basis, with carrying costs based on the 6.6% interest rate.[166]

139. Confluence Rivers agreed that any patronage credits actually received by the Company on a going-forward basis would be recorded in a liability account for treatment in the next rate case.[167]

Issues Presented by the Parties:

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

Decision on Cost of Debt

Regarding the cost of debt, the Commission finds that 6.60% is the appropriate regulatory cost of debt. It is the interest rate applied to Confluences Rivers' most recent debt issuance. OPC recommended 6.23% based on a presumption that a patronage credit discount would be given reducing Confluence Rivers cost of debt. However, the Commission finds that the CoBank loan was opened less than a year ago, which provides no history of a patronage credit discount being given or at what rate. Additionally, the patronage credit discount was not guaranteed to be given.

[165] Ex. 8, D'Ascendis Rebuttal, p. 49.
[166] Ex. 211, Murray Surrebuttal, p. 13.
[167] Tr. Vol. 10, p. 10.

Confluence has offered to track the patronage credit as a regulatory liability on a going-forward basis for consideration during Confluence Rivers' next rate case. The Commission finds this a just and reasonable resolution. The cost of debt shall be set at 6.60%, and Confluence Rivers shall track any patronage credits on a going forward basis and record those credits to a liability account for consideration in the next rate case.

Return on Equity

140. The authorized ROE is a regulatory ratemaking concept that quantifies the amount of net income allowed in the revenue requirement. The Cost of Equity (COE) is a market-based concept that quantifies an investors' required return on a common equity investment.[168]

141. The COE must be estimated based on market data and various financial models. Because the COE is premised on opportunity costs, the models used to determine it are typically applied to a group of "comparable" or "proxy" companies.[169]

142. Other than the loan Confluence recently closed with CoBank, there are no public market transactions to evaluate for purposes of estimating Confluence Rivers' COE.[170]

143. Confluence Rivers recommended an ROE at 11.35%, which is the midpoint of its range of 10.85% to 11.85%.[171]

144. Staff recommended an ROE of 9.50%, the midpoint of a range of 9.20% to 9.80%.[172]

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[168] Ex. 209, Murray Direct, p. 20.
[169] Ex. 7, D'Ascendis Direct, p. 8; Ex. 109, Walters Direct, pp. 25-26.
[170] Ex. 209, Murray Direct, p. 4.
[171] Ex. 7, D'Ascendis Direct, pp. 2-3, and 5.
[172] Ex. 109, Walters Direct, p. 3.

145. OPC recommended an ROE at 9.65% that is within its recommended range of 9.25% to 9.90%.[173]

146. The water utility rate case decisions across the United States from 2022 have an average rate award of 9.61%.[174] The median awarded ROEs for water utilities in 2022, nationally, was 9.75%.[175]

147. Staff's witness testified he was unaware of any other utilities that exclusively acquire small, distressed systems.[176] OPC testified it is not aware of any other utility companies making the acquisition of distressed systems a primary business model.[177]

148. Authorized ROEs for both electric and gas utilities have been below 10.0% for about the last nine years.[178]

149. OPC testified that ROEs have generally been set in the 9% range.[179]

Discounted Cash Flow Model

150. The Discounted Cash Flow (DCF) model posits that a stock price equals the sum of the present value of expected future cash flows discounted at the investor's required cost of capital.[180]

151. The multi-stage DCF model reflects the possibility of non-constant growth for a company over time. The multi-stage DCF model reflects three growth periods: (1) a short-term growth period consisting of the first five years; (2) a transition period, consisting

[173] Tr. Vol. 10, p. 121.
[174] Tr. Vol. 10, p. 87; Ex. 226, S&P Global water rate case report 2022.
[175] Ex. 109, Walters Direct, p. 6.
[176] Tr. Vol. 10, p. 115.
[177] Tr. Vol. 10, p. 137.
[178] Ex. 109, Walters Direct, p. 4.
[179] Ex. 209, Murray Direct, p. 20.
[180] Ex. 109, Walters Direct, p. 28.

of the next five years; and (3) a long-term growth period starting in year 11 and extending into perpetuity.[181]

152. Confluence Rivers applied a single-stage constant growth DCF model to its Utility Proxy Group, and used analysts' five-year forecasts of earning per share growth. The Utility Proxy Group results in a wide range of indicated ROEs from 5.08% to 14.28%. The mean result, the median result, and the average of the mean and median results is 9.28%.[182]

153. Mr. D'Ascendis biased his DCF results upward by removing only the low-end outlier when a DCF result of 14.28% was a high-end outlier.[183]

154. In its DCF analysis, Staff performed the following: 1) a constant growth DCF model using consensus analysts' growth rate projections; 2) a constant growth DCF using sustainable growth rate estimates; and 3) a multi-stage growth DCF model.[184] Staff's opinion that a reasonable ROE based on its DCF results is 9.20%.[185]

155. For its multi-stage growth DCF analysis, Staff applied an average long-term growth rate of 4.00%.[186] The long-term sustainable growth rate for a utility stock cannot exceed the growth rate of the economy in which it sells its goods and services in perpetuity. The long-term maximum sustainable growth rate for a utility investment is limited by the projected long-term gross domestic product (GDP) growth rate as that reflects the projected long-term growth rate of the economy as a whole. *Blue Chip*

[181] Ex. 109, Walters Direct, p. 34.
[182] Ex. 7, D'Ascendis Direct, pp. 22-24.
[183] Ex. 119, Walters Rebuttal, p. 10.
[184] Ex. 109 Walters Direct, p. 22.
[185] Ex. 109 Walters Direct. P. 38.
[186] Ex. 109, Walters Direct, p. 31.

Economic Indicators projected that over the next five and ten years, the U.S. nominal GDP will grow at an annual rate of approximately 4.00%.[187]

156. The Company used a 6.00% growth rate in perpetuity in its DCF model.[188]

Risk Premium Model

157. The Risk Premium Model can be expressed as bond yield plus.[189]

158. The Company's recommendation relied on the results of the application of two risk premium methods to the Utility Proxy Group. The first method is the Predictive Risk Premium Model (PRPM), while the second method is a risk premium model using a total market approach.[190]

159. The inputs to the PRPM are the historical returns on the common shares of each company in the Utility Proxy Group minus the historical monthly yield on long-term U.S. Treasury securities through October 2022.[191]

160. The average of the mean and median results of the Company's Utility Proxy Group applying PRPM calculated a cost of common equity rate of 12.20%.[192]

161. Confluence Rivers calculated a common equity cost rate of 11.48% for its Utility Proxy Group based on the total market approach.

162. The Company averaged the results of the two methods, the PRPM (12.20%) and the adjusted market approach (11.48%), for an RPM-derived common equity cost rate of 11.84%.[193]

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[187] Ex. 109, Walters Direct, p. 31.
[188] Tr. Vol. 10, p. 127.
[189] Ex. 109, Walters Direct, p. 34.
[190] Ex. 7, D'Ascendis Direct, p. 26.
[191] Ex. 7, D'Ascendis Direct, p. 27.
[192] Ex. 7, D'Ascendis Direct, p. 28.
[193] Ex. 7, D'Ascendis Direct, p. 38.

163. Staff recommended a ROE of 9.80% based on its risk premium analysis.[194]

164. The end-results of Confluence Rivers' risk premium assumptions are not consistent with reasonable capital market expectations.[195]

165. The Company's use of projected bond yields causes an upward bias of approximately 25 basis points. Its exclusion of capital gains and losses on bond returns causes an upward bias of approximately 100 basis points in its calculation of historical risk premiums.[196]

166. The Company's PRPM™-derived risk premium study adjusted result (i.e. after excluding two high-end outliers) of 12.28% is unreasonable when compared to the average authorized ROEs for electric, gas, and water utilities. The highest average authorized ROE of the three major regulated utility industries since 2006 is 10.52% for electric utilities in 2008. Further, natural gas utilities have not had an average authorized ROE of 12.28% or higher since 1991.[197]

167. The Company's adjusted total market approach risk premium results of 11.48% are also unreasonable as natural gas utilities have not had an average authorized ROE of 11.48% or higher since 1998.[198]

Capital Asset Pricing Model

168. In the Capital Asset Pricing Model (CAPM), the method of analysis is based upon the theory that the market-required ROR for a security is equal to the risk-free rate, plus a risk premium associated with the specific security.[199]

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[194] Ex. 109, Walters Direct, p. 43.
[195] Ex. 210, Murray Rebuttal, p. 10.
[196] Ex. 210, Murray Rebuttal, p. 20.
[197] Ex. Walters Rebuttal, p. 13.
[198] Ex. Walters Rebuttal, p. 13.
[199] Ex. 109, Walters Direct, p. 43.

169. The CAPM requires an estimate of the market risk-free rate, a company's beta,[200] and the market risk premium.[201]

170. The empirical CAPM (ECAPM) reflects the reality that while the results of these tests support the notion that beta is related to security returns, the empirical Security Market Line (SML) described by the CAPM formula is not as steeply sloped as the predicted SML.[202]

171. Confluence Rivers applied both the traditional CAPM and the ECAPM to its Utility Proxy Group and averaged the results.[203]

172. Confluence Rivers provided two methods of calculation of the beta: 1) the average beta of the Utility Proxy Group companies reported by Bloomberg Professional Services; and 2) the average beta of the Utility Proxy Group companies as reported by *Value Line*.[204] The Company used a risk-free rate adopted for both applications of the CAPM of 3.96%.[205] Confluence Rivers' calculation of the capital asset pricing model applied to the Utility Proxy Group resulted in an ROE of 12.00%.[206]

173. Staff calculated the CAPM using nine different methods, and recommended a CAPM return estimate of 9.40%.[207] Staff's beta used the average and median Market Intelligence betas of 0.85 and 0.85, respectively.[208] Staff used the projected 30-year

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[200] Beta measures the relative volatility of an investment. It is an indication of its relative risk. www.investopedia.com accessed October 19, 2023.
[201] Ex. 109, Walters Direct, p. 44.
[202] Ex. 7, D'Ascendis Direct, p. 39.
[203] Ex. 7, D'Ascendis Direct, p. 41.
[204] Ex. 7, D'Ascendis Direct, pp. 41-42.
[205] Ex. 7, D'Ascendis Direct, p. 42.
[206] Ex. 7, Schedule DWD-1, p.2.
[207] Ex. 109, Walters Direct, pp. 51-52.
[208] Ex. 109, Walters Direct, p. 44.

Treasury bond yield of 3.70% as provided by the *Blue Chip Financial Forecasts* for its CAPM analysis.

174. OPC performed a CAPM analysis that resulted in a range of 8.00% to 8.25% for the water utility industry.[209] OPC used a market risk premium of 4.95%, 6.00% and 6.38% and a beta of 0.75.[210]

175. The Company's reliance on an adjusted *Value Line* beta in its ECAPM study is inconsistent with the academic research supporting the development of the ECAPM.[211]

176. Confluence Rivers further increased the intercept and flattened the security market line by using projected long-term Treasury yields that are at odds with current market expectations and inconsistent with the Federal Reserve's projections and monetary policy.[212]

Adjustments

177. Confluence Rivers' smaller size relative to the Utility Proxy Group indicates greater relative business risk for the Company because, all else being equal, size has a material bearing on risk.[213]

178. Confluence Rivers requested a 1.00% upward ROE adjustment as a size premium.[214]

179. Confluence Rivers recommended a 0.51% downward ROE adjustment based on the differences in financial risk between Confluence Rivers and the Utility Proxy Group.[215]

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[209] Ex. 209, Murray Direct, p. 42.
[210] Ex. 209 Murray Direct, p. 41.
[211] Ex. 119, Walters Rebuttal, p. 19.
[212] Ex. 119, Walters Rebuttal, p. 20.
[213] Ex. 7, D'Ascendis Direct, p. 49.
[214] Ex. 7, D'Ascendis Direct, p. 52.
[215] Ex. 7, D'Ascendis Direct, p. 55.

180. The higher the level of risk, the higher the rate of return investors demand.[216]

181. OPC recommended an upward adjustment to the ROE to recognize that the systems rely on bank financing rather than direct access to debt capital markets, in addition to some uncertainty related to future financial performance of the acquired systems.[217]

182. Although qualifying its recommendation of 9.65% only if its own capital structure recommendation is used, OPC set its upper limit of its recommendation at 9.9% and not the full 1.00% zone of reasonableness up to 10.6%.

Zone of Reasonableness[218]

183. OPC considered the Commission's "zone of reasonableness standard"[219] for purposes of setting an allowed ROE, with the starting point being a recent industry average allowed ROE.[220]

184. The average allowed ROE for water utilities for 2022 was 9.61% based on eight cases (range of 9.10% to 10.00% with a median of 9.65%).[221]

185. OPC recommended the Commission use an allowed ROE of approximately 9.60% as the starting point for its zone of reasonableness standard. Subtracting 100 basis points from this average authorized ROE forms the basis for the low-end of the

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[216] Ex. 7, D'Ascendis Direct, p. 9; Ex. 109, Walters, p. 39.
[217] Ex. 209, Murray Direct, p. 20.
[218] Ex. 209, Murray Direct, pp. 22-23.
[219] *State ex rel. Missouri Gas Energy v. Public Service Commission,* 186 S.W.3d 376, 383 (Mo App. W.D. 2005).
[220] Ex. 209, Murray Direct, p.21.
[221] Ex. 209, Murray Direct, p. 22.

Commission's zone of reasonableness of 8.6% with 10.6% representing the high-end of the Commission's zone of reasonableness.[222]

Conclusions of Law Regarding Return on Equity

V. Missouri court decisions recognize that the Commission has flexibility in fixing the rate of return, subject to existing economic conditions.[223] "The cases also recognize that the fixing of rates is a matter largely of prophecy and because of this, commissions in carrying out their functions, necessarily deal in what are called 'zones of reasonableness', the result of which is that they have some latitude in exercising this most difficult function."[224]

W. The United States Supreme Court has instructed the judiciary not to interfere when the Commission's rate is within the zone of reasonableness.[225]

X. In determining whether the rates proposed are just and reasonable, the Commission must balance the interests of the investor and the consumer.[226] In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[227]

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[222] Ex. 209, Murray Direct, p. 22.

[223] *State ex rel. Laclede Gas Co. v. Public Service Commission*, 535 S.W.2d 561, 570-571 (Mo. App. 1976).

[224] *State ex rel. Laclede Gas Co. v. Public Service Commission*, 535 S.W.2d 561, 570-571 (Mo. App. 1976). In fact, for a court to find that the present rate results in confiscation of the company's private property that court would have to make a finding based on evidence that the present rate is outside of the zone of reasonableness, and that its effects would be such that the company would suffer financial disarray. *Id*.

[225] *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 574 (Mo. App. 2009). *See, In re Permian Basin Area Rate Cases,* 390 U.S. 747, 767, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968) ("courts are without authority to set aside any rate selected by the Commission [that] is within a 'zone of reasonableness' ").

[226] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, (1944).

[227] *Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 690 (1923).

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[228]

The Supreme Court has further indicated:

> '[R]egulation 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 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.[229]

Y. In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

> Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.[230]

[228] *Bluefield,* at 692-93.
[229] *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944) (citations omitted).
[230] *Federal Power Commission v. Natural Gas Pipeline Co*. 315 U.S. 575, 586 (1942).

Z. Furthermore, in quoting the United States Supreme Court in *Hope Natural Gas*, the Missouri Court of Appeals said:

> [T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' … Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts.[231]

Issues Presented by the Parties

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

Decision on Return on Equity

The Commission must ensure the utility has sufficient opportunity to earn enough revenue to pay its debts and should be sufficient to assure confidence in the financial integrity of the utility, so as to maintain its credit and to attract capital. While the Commission is not bound to the use of any single formula or combination of formulae in determining rates, there are three that are commonly used and were used in this case by all three parties.

The Commission does not find the Company's calculation of ROE to be credible. The Company's use of high inputs and assumptions not consistent with industry standards led to high outputs.

Confluence Rivers is a for-profit company which has focused on expansion via acquisition of distressed water and sewer systems. The acquisition of distressed systems is not rare in itself, but it is certainly not the typical situation of one utility acquiring another.

[231] *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).

Many of the systems Confluence Rivers acquired are distressed to the point of being in receivership and/or being requested to be purchased by the Commission or DNR.

The Commission will use the 2022 average of water utility rate award of 9.61 to establish its zone of reasonableness check, 8.61 to 10.61.

Confluence Rivers and OPC factored in adjustments to their ROE's to account for the increased risk of the Company compared to its proxy groups. Staff did not factor in a similar adjustment. The Commission finds that Confluence Rivers' recommended ROE of 11.35% (before an upward adjustment) is not reasonable as this is outside the established zone of reasonableness in this case and is 174 basis points higher than the average authorized ROE awarded in the nation in 2022. The Commission finds that Staff's recommended ROE of 9.50% is not reasonable as this does not account for Confluence Rivers' increased risk compared to its proxy group.

OPC recommended an ROE in the range of 9.25% to 9.90%, a 65 basis point range. OPC recommended a 65 basis point upward adjustment to its recommended ROE of 9.00% for an adjusted ROE of 9.65% to recognize that Confluence Rivers acquired systems relying on bank financing rather than direct access to debt capital markets, as well as some uncertainty related to future financial performance of the acquired systems. The Commission finds the high-end of OPC's range at 9.90% appropriately reflects the increased risk that Confluence Rivers faces from acquiring distressed water and sewer systems.

The Commission has concerns after listening to public comments about the impact of this rate increase on customers. The socialization of costs by combining rate districts in this case would have some customers pay more even though improvements to the utility systems they utilize have not been completed. The Commission also considers the importance of safe drinking water to be a major concern for customers of distressed water utility systems.

The Commission finds an ROE of 9.90% will appropriately balance the interests of customers, allow the utility an opportunity to earn a fair and reasonable return, and provide safe and reliable service at just and reasonable rates.

ADVANCED METER INFRASTRUCTURE (AMI)

Findings of Fact Regarding AMI

186. Confluence Rivers has at least two systems, Indian Hills and Hillcrest, where it has installed an Automated Metering Infrastructure (AMI) meter attachment on its Badger Disc Series meters.[232]

187. The AMI meter attachment, which is an Orion Cellular Water Endpoint, enables Confluence Rivers' Badger meters to have interoperable capability to Internet of Things cellular infrastructure.[233]

188. AMI is a system of meters that provides for remote collection of water use data in real time.[234]

189. The AMI attachments at issue were installed by Confluence Rivers.[235]

190. Anticipated AMI benefits for customers are a greater level of accuracy and visibility into their utility accounts and usage, quicker identification of high-use events and leak detection, and a decrease in operational expense by eliminating manual meter reading.[236]

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[232] Ex. 206, Marke Direct, p. 8.
[233] Ex. 206, Marke Direct, p. 9.
[234] www.epa.gov/watersense/advanced-metering-infrastructure, accessed September 14, 2023.
[235] Tr. Vol 10, pp. 4-5. (Oral Joint Stipulation of Fact).
[236] Ex. 206, Marke Direct, p. 9.

191. Confluence Rivers has not made the investment in an IT customer portal software to enable those customers to visualize 15-minute interval data of water usage.[237] Additionally, Confluence Rivers' current customer bills do not possess the means to convey interval data.[238]

192. OPC recommended the amount of $26,768 should be disallowed from recovery from ratepayers in relation to the AMI meter attachments.[239]

193. The $26,768 cost disallowance represents three-quarters of the sum of the net plant for accounts 346 and 347 (which represent meters and meter installation respectively) multiplied by the OPC's recommended rate of return (as developed by OPC witness David Murray at 7.77%) plus the annual depreciation expense related to those same accounts for the Hillcrest and Indian Hills systems ("three-quarters cost disallowance").[240]

194. OPC recommended its three-quarters cost disallowance based on its research that the water meter utilized by Confluence Rivers would cost approximately $75.00 compared to the AMI meter attachment, which costs an additional $220.[241]

195. OPC also recommended that the Commission order the Company to cease further deployment of AMI attachments.[242]

196. AMI can eliminate manual meter reading.[243]

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237 Ex. 206, Marke Direct, pp. 9-10.
238 Ex. 206, Marke Direct, pp. 10-11.
239 Ex. 208, Marke Surrebuttal, pp. 13-14.
240 Ex. 208, Marke Surrebuttal, p. 14.
241 Ex. 208, Marke Surrebuttal, p. 14.
242 Ex. 206, Marke Direct, p. 12.
243 Ex. 206, Marke Direct, p. 9.

197. The annual salary for a Missouri-based water meter reader is $35,236 with top earners making approximately $65,000 and the low-end average by a city at $32,214 for the City of Independence.[244]

198. OPC argued that the salary of a meter reader for more remote systems, such as those serviced by Confluence Rivers, would be lower than the low-end average by a city such as Independence.[245]

199. Confluence Rivers' annual third-party operations and maintenance (O&M) costs for its water and sewer system are roughly $1,694,426.[246]

200. Confluence Rivers' recently issued Request for Proposals (RFP) related to third-party operating and maintenance costs resulted in an average 5.53% reduction in monthly O&M cost per system or close to $93,701 in savings.[247] [248]

201. Indian Hills is located in Crawford County, Missouri.[249] It is the only system Confluence Rivers operates in Crawford County.

202. Hillcrest is located in Cape Girardeau County, Missouri.[250] It is the only system Confluence Rivers operates in Cape Girardeau County.

203. Confluence Rivers' O&M contractors are not only responsible for meter reading at water systems, but many other services, such as water sampling and testing, weekly inspections, maintenance, and monitoring alarms and remote controls.[251]

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[244] Ex. 206, Marke Direct, p. 12.
[245] Ex. 206, Marke Direct, p. 12.
[246] Ex. 207, Marke Rebuttal, p. 9.
[247] Ex. 20, Thomas Direct, p. 12.
[248] 5.53% x $1,694,426 = $93,701 in annual savings for all of the systems.
[249] Ex. 225, Indian Hills Report and Order from WR-2017-0259, p.3
[250] Ex. 134, Hillcrest Disposition Agreement from WR-2016-0064, p. 1.
[251] Ex. 20, Thomas Direct, Schedule TT-3, pp. 7-8.

204. Because the Company's systems are scattered across Missouri, travel time to and from the systems is a necessary consideration of any staffing analysis.[252]

Conclusions of Law

AA. In determining whether a utility's conduct was prudent, the Commission will judge that conduct by:

> asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, [the Commission's] responsibility is to determine how reasonable people would have performed the tasks that confronted the company.[253]

BB. The Missouri Supreme Court further affirmed the Commission's rationale in stating,

> The PSC ordinarily applies a presumption of prudence in determining whether a utility reasonably incurred its expenses. This presumption of prudence will not survive a showing of inefficiency or improvidence that creates serious doubt as to the prudence of an expenditure. If such a showing is made, the presumption drops out and the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.[254]

CC. It would be inconsistent with the statutory authority provided by Section 393.130.1, RSMo, for the Commission to make a decision on the recoverability of costs based upon a prudency analysis without reference to the detrimental impact of those practices to the ratepayers.[255]

DD. Subsection 393.150.2, RSMo, states that the utility bears the burden of proving that a requested rate is just and reasonable.

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[252] Ex. 6, Cox Surrebuttal, p. 39.
[253] *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Com'n,* 954 S.W.2d 520, 529 (Mo. App. W.D. 1997).
[254] *Spire Missouri, Inc. v. Pub. Serv. Com'n*, 618 S.W.3d 225, 232 (Mo. banc 2021) (internal citations and quotation marks omitted).
[255] *Associated Natural Gas* at 530.

EE. Although the utility always bears the burden of proving that a proposed rate increase is just and reasonable, the Commission will, in the absence of adequate contrary evidence, presume that a utility's costs incurred through arm's-length transactions were prudently incurred. This presumption of prudence affects who has the burden of proceeding, but does not change the burden of proof.[256]

Issue Presented by the Parties

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

Decision Regarding AMI

The Commission has concerns with the analysis presented by OPC on this issue. Regardless that its customers cannot currently access 15-minute intervals for their water usage, there are significant benefits to Confluence Rivers and its customers to have access to the AMI meter technology – more accurate meter reading; leak detection; and reduced operation costs.

OPC's analysis fails to consider the unique geographical locations of the Confluence Rivers' water systems. The Indian Hills and Hillcrest systems are both the only system that Confluence Rivers operates in their respective counties. The location of these two systems relative to each other and other Confluence Rivers systems would likely indicate that operational savings would not only include a meter reader salary, which OPC acknowledged, but would also include additional operation cost saving and saving worker travel time between systems.

The Commission finds that OPC has not shown an inefficiency or improvidence that creates serious doubt as to the question of prudence in installing AMI attachments in

[256] *Office of Pub. Counsel v. Mo. Pub. Serv. Com'n*, 409 S.W.3d 371, 376-379 (Mo. banc 2013).

Indian Hills and Hillcrest. The Commission further finds that OPC did not show a detrimental impact to customers.

THIRD-PARTY CONTRACT OPERATORS

Findings of Fact:

205. Confluence Rivers utilizes contract operators to run all of its treatment, distribution, and collection systems. Confluence Rivers does not employ water or sewer field operations staff in-house.[257]

206. The Company's use of third-party contractor operators has been in place for almost ten years, with no letters of violation from DNR.[258]

207. CSWR identifies qualified contractors via a written Request for Qualifications (RFQ).[259]

208. The Company then sends an RFP to the qualified contractors.[260]

209. For purposes of soliciting bids, Confluence Rivers will combine systems regionally as its systems are geographically dispersed.[261]

210. There are approximately 31 persons employed via third-party contactor operators to service Confluence Rivers' Missouri systems.[262]

211. Current contractors provide service on a 24-hour, seven-days a week, and 365 days per year basis (24/7/365).[263]

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[257] Ex. 17, Thies Direct, p. 11, and Ex. 108, Gateley Direct, p. 6.
[258] Tr. Vol. 11, p. 82.
[259] Ex. 20, Thomas Direct, p. 6.
[260] Ex. 20, Thomas Direct, p. 8.
[261] Ex. 20, Thomas Direct, p. 9.
[262] See OPC brief, p. 78 to back track and get cite.
[263] Ex. 20, Thomas Direct, Schedule TT-3, pp. 5 – 8.

212. OPC alleged that Confluence Rivers' usage of third-party contractors was imprudent.[264] However, OPC witness Marke acknowledged that the third-party contractor based model initially made a lot of sense to him when Confluence Rivers began operating.[265]

213. OPC proposed to divide Confluence Rivers' water and wastewater systems into nine regions.[266]

214. OPC recommended a disallowance of $1,094,426 (of the $1,694,426) with the remainder of $600,000 going to hire, train, and equip nine in-house certified water and wastewater operator to replace the third-party contractors.[267]

215. In response to OPC's calculation of nine in-house operators, Confluence Rivers estimated that it would require approximately 22 employees to staff operations and maintenance with in-house personnel. The number of employees is due in part to: Occupational Safety and Health Administration (OSHA) regulations that require certain tasks be conducted by a team of operators; the nature and complexity of the Company's systems; the need for personnel to operate the system and personnel to repair the systems; and the geographically scattered nature of the Company's systems.[268]

216. A disallowance of recovery of the third-party contractor costs, if approved, would not void the contracts in place between Confluence Rivers and its third-party operators.[269]

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[264] Tr. Vol. 11, p. 128.
[265] Tr. Vol. 11, p. 130.
[266] Ex. 207, Marke Rebuttal, p. 12.
[267] Ex. 207, Marke Rebuttal, pp. 14-15. OPC's recommended disallowance and discussion of third-party contractors focused on operators and not the third-party contractor used for customer service functions as it appears to be addressed under issue 14, Call Center Expense, which has been settled.
[268] Ex. 6, Cox Surrebuttal, p. 33, pp. 36-39, and p. 39.
[269] Tr. Vol. 11, p. 82.

217. OPC based its allegation of imprudence on its calculation of the cost to hire nine in-house personnel divided by geographic region. The nine would receive an approximate salary of $60,000 each, which OPC contended is higher than the mean wage of $48,220 according to the Missouri Economic Research and Information Center (MERIC) database. The remaining $60,000 would be used for overtime and other expenses.[270]

218. The Company's experience is that the salary required to hire a water and wastewater system operator is much greater than $60,000 – driven in large part by the rapid retirement of skilled operators.[271]

219. Confluence Rivers argued that outdated data, employment market changes, and other factors related to operating systems in rural Missouri make using the MERIC database as the sole and only data set for setting salaries inappropriate. The MERIC database utilized by OPC uses 2021 salary levels as a data source and OPC did not adjust its numbers to reflect the cost of living adjustment factors for 2022 and 2023. Adjusting OPC's $48,222 estimated salary for cost of living would result in an average salary of $55,508.[272]

220. Additionally, the MERIC data may not be reliable due to its opt-in reporting. [273]

221. OPC's analysis also fails to recognize a significant market change – the 4.1% Missouri unemployment rate in 2021 dropped to 2.5% in 2022. This change means

[270] Ex. 207, Marke Rebuttal, pp. 9-10.
[271] Ex. 6, Cox Surrebuttal, p. 33, and pp. 35-36.
[272] Ex. 19, Thies Surrebuttal, page 5.
[273] Tr. Vol. 11, p. 95.

that fewer individuals were looking for work and the cost to attract an employee could be higher as a result.[274]

222. OPC's estimated total salary and benefits package only incorporated $11,780 or 19.6% for the total costs for payroll taxes and benefits. However, the Bureau of Labor Statistics suggests that the portion of a total compensation package for private company employees that comprises taxes and benefits is 29.5%.[275]

223. To include payroll taxes and benefits at 29.5% instead of 19.6% to the OPC estimate of $60,000 in salary and benefits per water or wastewater operator would be updated to a range of $71,760 to $77,700.[276]

224. Including cost of living adjusted salary levels, 29.5% payroll taxes and benefits, estimated training and equipment costs, and the estimated vehicle costs, the cost to employ one operator is $91,463 per year.[277]

225. In Confluence Rivers' experience, it was more economical to identify and retain third-party contractors who have the required certifications rather than hire, train, and retain individual employees to reach the same level of qualifications and experience.[278]

226. A water operator or wastewater operator is someone who has a certification to operate a water or wastewater plant, respectively. The certification includes training and time spent operating a water or wastewater plant. Certification in each of the different

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[274] Ex. 18, Thies Rebuttal, p. 17.
[275] Ex. 19, Thies Surrebuttal, p. 6.
[276] Ex. 19. Thies Surrebuttal, p. 6.
[277] Ex. 19, Thies Surrebuttal, Schedule BT-SR-1.]
[278] Ex. 20, Thomas Direct, p. 5.

classes of plant require different tests, different educational components, different amounts of experience, and ongoing continuing education credits.[279]

227. A wastewater operator needs certification from DNR.[280]

228. A water operator needs certification from DNR.[281]

229. OPC suggested that the job of water or wastewater system operator may need only a high-school education.[282]

230. OPC identified operator certification courses offered by DNR lasting from one day to 12 days.[283]

231. Certified water and wastewater operators employ technicians.[284]

232. Technicians include skilled trades such as mechanics, plumbers, and electricians.[285]

233. Technicians do not need to be certified.[286]

234. A technician can perform certain tasks under the supervision and direction of a certified operator.[287]

235. Dispersed system locations and the number of connections negatively impact the ability of Confluence Rivers to cost-effectively employ an in-house workforce of sufficient size to perform all required operations and maintenance functions.[288]

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[279] Tr. Vol. 11, p. 37.
[280] Tr. Vol. 11, p. 25.
[281] Tr. Vol. 11, p. 25.
[282] Tr. Vol. 11, p. 120.
[283] Ex. 207, Marke Rebuttal, p. 14.
[284] Tr. Vol. 11, p. 27.
[285] Tr. Vol. 11, p. 27.
[286] Tr. Vol. 11, p. 38.
[287] Tr. Vol. 11, p. 110.
[288] Ex. 20, Thomas Direct, p. 5.

236. The Company recently completed an RFP that covered most of its Missouri systems, and estimated that the monthly operations and maintenance expense has decreased 5.53% per system.[289]

237. OPC's estimate of $600,000 in costs for in-house operators did not take into account the cost for vehicle expense, supplies, tools, or personal protective equipment.[290]

238. OPC's initial estimate of the cost of hiring in-house personnel did not include vehicles, fuel, vehicle insurance or vehicle maintenance, but during the hearing estimated a cost of $12,000 annually per region.[291]

239. OPC's initial estimate of the cost of hiring in-house personnel did not include offices, warehouse space, maintenance, or utilities, but during the hearing estimated a cost of $12,000 annually per region.[292]

240. OPC's estimate of the cost of hiring in-house personnel did not consider the availability of qualified workers, unemployment levels by region, or unemployment levels statewide.[293]

241. In the present instance, the use of third-party contractor operators avoids otherwise necessary expenditures such as trucks, tools, training, and warehouses.[294] Third-party contractor operators store the chemicals used in Confluence Rivers' water and sewer systems.[295]

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289 Ex. 20, Thomas Direct, p. 12.
290 Ex. 19. Thies Surrebuttal, p. 6.
291 Tr. Vol. 11, pp. 118-119.
292 Tr. Vol. 11, p. 119.
293 Tr. Vol. 11, pp. 121-122.
294 Tr. Vol. 11, p. 83.
295 Tr. Vol. 8, p. 157.

242. OPC's alternative recommendation was to replace the third-party operators with 20 in-house employees, which would result in a cost savings of $493,000 based on an annual salary of $60,000 per employee.[296]

243. Because the Company's systems are scattered across Missouri, travel time to and from the systems is a necessary consideration of any staffing analysis.[297]

244. Confluence Rivers estimated that the annual cost of an internal operations department would be $2,248,018.[298]

245. OPC's recommended disallowance of a portion of Confluence Rivers' third-party operator's expense would likely impair the quality of service.[299]

246. Staff agreed that it was possible that contracting for third-party operators in this situation may be a lower cost option than having in-house personnel, depending on inputs and circumstances.[300]

247. As part of a settlement,[301] the Company will make a full cost-benefit analysis study of whether it is more cost-effective to use third-party operators as opposed to in-house personnel.[302]

Conclusions of Law

No additional Conclusions of Law are necessary to this issue.

Issue Presented by the Parties

> *Should the Commission order a disallowance related to Confluence Rivers' contract-based business model, and if so, how much?*

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296 Tr. Vol. 11, pp. 117-118
297 Ex. 6, Cox Surrebuttal, p. 39.
298 Ex. 6, Cox Surrebuttal, p. 40; and Ex. 19, Thies Surrebuttal, p. 7.
299 Staff's Initial Brief, p. 40.
300 Tr. Vol. 11, p. 112.
301 *Order Approving Agreements*, issued September 27.
302 Tr. Vol. 11, p. 108.

Decision Regarding Third-Party Contractor Operators

OPC's allegation of imprudence rests solely on a cost comparison between the actual costs of approximately $1.6 million for third-party contract operators (over 31 operators, technicians and other employees including skilled labor providing service 24/7/365) versus OPC's estimate of $600,000 for nine operators in nine regions.[303] OPC attempted to show that operations and maintenance can be done more cheaply than it is currently. OPC then attempted to show that the amount of savings, approximately $1.2 million, is large enough to raise a question of imprudence regarding Confluence Rivers decision to use third-party contractors for operations and maintenance of its systems. The Commission finds that OPC has not carried its burden of showing inefficiency or improvidence that created serious doubt as to the prudence of third-party contract operators in its suggestion that nine full time in-house employees can effectively replace a 31-employee third-party, 24 hours a day ("24/7/365") contract operator system.

OPC's analysis oversimplified the complexities required to operate the numerous water systems and wastewater systems owned by Confluence Rivers. OPC's estimate of a $60,000 salary for operators significantly underestimated the realistic salary required to attract a skilled operator as it did not include cost of living adjustments and the appropriate percentage for benefits and taxes, which Confluence Rivers estimated would more appropriately be in the range of $71,760 to $91,463. OPC's analysis did not appropriately take into consideration the need for additional staff such as technicians. It also did not adequately address in-house employee needs such as vehicles, vehicle insurance, vehicle maintenance, office space, warehouse space, maintenance for the office and

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[303] OPC's Initial Brief offered a calculation for 15 in-house employees. Because this was offered in briefs, it is not in evidence and will not be considered except in limited references to show that it falls short regardless.

warehouse, or utility costs for the office(s) and warehouse(s). Further, OPC's estimated costs do not take into consideration the low unemployment levels in Missouri, the availability of qualified certified operators and OSHA requirements that may impact staffing.

OPC's calculations do not address two essential advantages of Confluence Rivers' current system – 24/7/365 coverage of its operators; and skilled labor. OPC offered no evidence that its 9 (or 20) employees would be on call 24/7/365.

Confluence Rivers' systems are typically distressed when purchased, and the Commission finds those repairs – with the variety of components and hence a variety of needed licensing – would be unlikely to be able to be addressed by an employee with only a high school education and holding an operator's certificate obtained after attending a one-day seminar. The cost to replace the skilled trades currently working as technicians under the supervision of third-party operators is also not addressed by OPC.

OPC failed to adequately address what changed from its initial view that third-party operators where a good idea to being an imprudent choice. OPC also failed to address Staff's concern that essentially firing the 31 third-party contract operators before hiring the nine (or 20) in-house personnel would likely impair the current quality of service. And OPC failed to adequately explain why it would not be better to make such a decision after the cost-benefit study that is agreed to, rather than immediately disallow recovery of the cost of the third-party contractors prior to hiring and training replacement operators.

Lastly, OPC has not supplied sufficient evidence for the Commission to be able to find that actual or financial harm to ratepayers has occurred. Thus, the Commission concludes that OPC has not raised a sufficient question or doubt as to the prudence of Confluence Rivers' decision to continue using the third-party contract operators.

CONCLUSION:

The Commission, having considered the competent and substantial evidence upon the whole record, makes the above findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making these findings. Any failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission did not consider relevant evidence, but indicates rather that omitted material is not dispositive of this decision.

Except as otherwise set out in the body of this order, the Commission finds that Confluence Rivers has met its burden of proof to show that an increased rate is just and reasonable. Thus, the Commission concludes, based upon its review of the whole record that rates approved as a result of this order support the provision of safe and adequate service. The revenue requirement authorized by the Commission in this case is no more than what is sufficient to keep Confluence Rivers' utility plant in proper repair for effective public service and provide to Confluence Rivers' investors an opportunity to earn a reasonable return upon funds invested.

By statute, orders of the Commission become effective in thirty days, unless the Commission establishes a different effective date.[304] To allow Confluence Rivers the opportunity to implement the approved rates beginning closest to the calculated operation of law date (November 20), the Commission finds it reasonable to make this order effective in less than 30 days.

[304] Section 386.490.2, RSMo.

THE COMMISSION ORDERS THAT:

1. The tariff sheets submitted on December 21, 2022, and assigned Tracking Nos. YW-2023-0113 and YS-2023-0114 are rejected.

2. The income tax expense for the revenue requirement shall be calculated in this rate case consistent with the methodology used by Staff in prior Confluence Rivers' rate cases. Confluence Rivers is directed to calculate income tax expense by multiplying the rate base by the Commission authorized rate of return and then the statutory tax rate.

3. Acquisition costs in part shall be recovered through a capitalization of some costs and a five-year amortization without rate base treatment of some other costs, as described in the body of this order.

4. Confluence Rivers shall continue to keep timesheets for all employees other than the executive and director staff positions identified in the body of this order.

5. The appropriate cost of capital shall be based on a ROE of 9.90%, a cost of debt of 6.60%, and a hypothetical capital structure of 50% equity and 50% debt. Confluence River will maintain records of all patronage credits received related to its debt issuances until its next rate case.

6. OPC's request for a disallowance regarding AMI investment in Indian Hills and Hillcrest is denied.

7. OPC's request for a disallowance regarding third-party contracting is denied.

8. Confluence Rivers is authorized to file tariff sheets sufficient to recover revenues approved in compliance with this order and the *Order Approving Agreements*, issued September 27, 2023.

9. This *Report and Order* will become effective on November 4, 2023.

BY THE COMMISSION

Nancy Dippell

Nancy Dippell
Secretary

Rupp, Chm., Coleman, Holsman, Kolkmeyer
and Hahn CC., concur and certify compliance
with the provisions of Section 536.080, RSMo (2016).

Hatcher, Senior Regulatory Law Judge

STATE OF MISSOURI

OFFICE OF THE PUBLIC SERVICE COMMISSION

I have compared the preceding copy with the original on file in this office and I do hereby certify the same to be a true copy therefrom and the whole thereof.

WITNESS my hand and seal of the Public Service Commission, at Jefferson City, Missouri, this 25th day of October, 2023.

Nancy Dippell

Nancy Dippell
Secretary

MISSOURI PUBLIC SERVICE COMMISSION

October 25, 2023

File/Case No. WR-2023-0006

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Enclosed find a certified copy of an Order or Notice issued in the above-referenced matter(s).

Sincerely,

Nancy Dippell

Nancy Dippell
Secretary

Recipients listed above with a valid e-mail address will receive electronic service. Recipients without a valid e-mail address will receive paper service.