Mr. Murray Memorandum

PUBLIC

The information that is redacted in Mr. Murray's memorandum is redacted because another party has identified that information to be confidential. *See* 20 CSR 4240-2.135(2)(A)3, 2(A)4, 2(A)6, (5)(A).

MEMORANDUM

To: Public Service Commission of the State of Missouri

From: David Murray, Chartered Financial Analyst, Office of the Public Counsel

Subject: Office of the Public Counsel Response to Staff Recommendation

Date: January 9, 2025

I. Introduction

The Office of the Public Counsel (the "OPC") has reviewed the Staff of the Public Service Commission of the State of Missouri's ("Staff" and the "Commission," respectively) Recommendation to approve Confluence Rivers Utility Operating Company, Inc.'s ("Confluence") proposed acquisition of nineteen wastewater systems in Callaway and Morgan Counties. Staff states in its Recommendation that the rates Missouri American Water Company ("MAWC") currently charges the customers of these systems "were designed to support the cost of service."[1] Confluence has specifically proposed to adopt MAWC's existing tariffs and rates of these systems at closing of the requested transaction.[2] Although Staff did not expressly indicate such in its Recommendation, the OPC assumes that Staff's conclusion of "not detrimental to the public interest" is based, at least in part, on Confluence's proposal to adopt MAWC's existing tariffs, resulting in no immediate rate increase to these customers. However, Staff did not address the anticipated rate impact to customers of these systems after Confluence files a rate case including these systems. Based specifically on Confluence's requested rates of return in past rate cases before the Commission, it is reasonable to expect that if the Commission approves Confluence's acquisition of these systems, it will request a higher revenue requirement for these systems based on a higher rate of return ("ROR") and potentially higher rate base.[3]

II. Analysis: Current Customers of These Systems Will Likely be Subject to Higher Rates Under Confluence's Ownership Due to a Higher Rate of Return and the Potential for a Higher Rate Base

In Confluence's most recent rate case, Case No. WR-2023-0006, it requested an authorized ROR premised on a ratemaking capital structure consisting of 68.56% common equity and 31.44%

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[1] Recommendation 16.

[2] *Id.* 14, 16.

[3] At this time, the OPC has not investigated other ratemaking elements which may impact the rates charged to these systems under Confluence's ownership.

long-term debt.[4] In that same case, Confluence requested a 11.35% return on equity ("ROE")[5] and a 6.60% cost of long-term debt.[6]

In MAWC's current rate case, Case No. WR-2024-0320, it requests an authorized ROR premised on a ratemaking capital structure consisting of 50.39% common equity and 49.61% long-term debt.[7] MAWC requests a 10.75% ROE[8] and a 4.56% cost of long-term debt.[9]

Using these numbers, all of Confluence's requested ROR inputs are more costly than MAWC's requested ROR inputs. Based on Staff's estimated net book value of ** [redacted] ** for all nineteen systems[10] and Confluence's identified net book value of ** [redacted] **[11] Confluence's requested ROR and higher rate base would cause an approximate $68,239 annual increase to the revenue requirement for these systems (approximately $113 per connection). After factoring in the expected capital expenditures (** [redacted] ** of plant and ** [redacted] ** for preliminary survey and investigation),[12] the estimated future rate base for these systems is ** [redacted] ** based on Staff's estimates and ** [redacted] ** based on Confluence's estimates. Applying the requested ROR figures to these estimated rate bases, Confluence's requested ROR would cause an approximate $172,885 (approximately $285 per connection) higher annual revenue requirement under Confluence's ownership as compared to MAWC's ownership.

The OPC also estimated the revenue requirement impact based on comparing Confluence's recent authorized ROR as compared to the ROR parties agreed to allow MAWC to use for its WSIRA applications.[13] Based on this scenario, the increase to the revenue requirement from ROR would be $35,692 on an annual basis (approximately $59 per connection) based on current net book value of plant and $78,099 on an annual basis (approximately $129 per connection) based on projected net book value after additional capital expenditures.

It should be noted that the Commission supported its higher authorized ROR for Confluence in its 2023 rate case, in part, by noting Confluence's strategy of "acquiring distressed water and sewer systems."[14] The systems that are the subject of this transaction are not distressed. Rather, Staff notes in its Recommendation that the systems are "properly constructed and have

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[4] Ex. 7 "D'Ascendis Direct Testimony" 2-3, 15, Case No. WR-2023-0006, Doc. 178. The Commission in that case authorized Confluence to use a capital structure consisting of 50% equity and 50% debt. Comm'n Report & Order 46, Case No. WR-2023-0006, Doc. 291.
[5] The Commission found that a 9.90% ROE appropriate. Comm'n Report & Order 60, Case No. WR-2023-0006.
[6] D'Ascendis Direct Test. 2-3, 5. The Commission authorized Confluence to use a 6.60% cost of debt. Comm'n Report & Order 47-48, Case No. WR-2023-0006.
[7] LaGrand Supplemental Direct Test. Attachment 1, Case No. WR-2024-0320, Doc. 46.
[8] Bulkley Direct Test. 8, Case No. WR-2024-0320, Doc. 13.
[9] LaGrand Supplemental Direct Test. Attachment 1, Case No. WR-2024-0320.
[10] Recommendation 9.
[11] This amount is equivalent to Confluence's proposed purchase price. Confluence used this amount as the starting net book value of Property, Plant, and Equipment in the pro forma balance sheet attached to its Application.
[12] Confluence's Response to Staff Data Request No. 0024.
[13] In MAWC's last general rate case, the parties agreed and the Commission approved that MAWC would use an overall pre-tax weighted average cost of capital of 8.65% for purposes of the WSIRA. Stipulation & Agreement 2, Case No. WR-2022-0303, Doc. 240.
[14] Report & Order 59, Case No. WR-2023-0006, Doc. 291.

been well maintained, but they are aged."[15] MAWC and Confluence's Joint Application in this case states that MAWC desires to divest these wastewater systems because they do not overlap with its water service areas, which distracts from MAWC's "main operational strengths and large-scale facilities."[16] Confluence maintains that acquiring these systems is consistent with its specialization of "running and rehabilitating small systems."[17] While the nineteen systems apparently need additional capital expenditures in the future, MAWC has not allowed these systems to become unreliable and unsafe.[18] Therefore, these systems are not comparable to past systems Confluence has acquired and rehabilitated, which the Commission recognized in authorizing Confluence a higher ROR.

III. Conclusion: The Commission Should Impose Additional Conditions to Protect Current Customers from Higher Rates

The OPC recommends the following conditions to ensure this transaction is not detrimental to customers due to Confluence's potential request for a higher ROR and higher rate base than otherwise would be awarded MAWC for the same systems. Unless the Commission orders and enforces these conditions, or similar conditions, the OPC opposes the proposed transaction.

1. Confluence commits that for the systems subject to this transaction, it will not request a higher pre-tax rate of return than MAWC would seek if it were still the owner of the systems subject to this transaction. For purposes of enforcing this condition, the parties agree that the maximum pre-tax rate of return Confluence shall request will be determined based on MAWC's most recently filed general rate case;[19]

2. If the Commission sets MAWC's authorized pre-tax rate of return in MAWC's most recent rate case (or the parties agree to a specified pre-tax rate-of-return as part of a settlement), this is the maximum pre-tax rate of return that Confluence will sponsor in its next rate case for purposes of determining the revenue requirement for the systems subject to this transaction;

3. If the income tax rate used to determine MAWC's effective pre-tax authorized rate of return is higher than Confluence's income tax rate, then the maximum pre-tax authorized rate of return that Confluence will sponsor for use in setting the rates of these particular systems in its next rate case will be adjusted downward accordingly;

[15] Recommendation 3.
[16] J.Appl. 6.
[17] *Id.*
[18] *See* Recommendation 3.
[19] In the event that Confluence files a general rate case before MAWC files its next general rate case (the case *after* Case Number WR-2024-0320), these conditions refer to Case Number WR-2024-0320. In the alternative event, these conditions refer to MAWC's forthcoming rate case.

4. Require Confluence to adhere to the acquisition accounting guidance provided in the USOA so that a request for rate recovery can be properly audited in Confluence's next rate case.

The above conditions are consistent with the spirit of the safeguards the Commission imposed on the Laclede Gas Company (now Spire Missouri) when it proposed to acquire the Missouri Gas Energy (now Spire Missouri West) natural gas distribution system from Southern Union in Case Number GM-2013-0254. The conditions are also consistent with attempts to safeguard customers of The Empire District Electric Company from the potential higher costs of capital from its new indirect owners, Algonquin Power & Utilities Corp, in Case Number EM-2016-0213. Further, the fourth condition above is consistent with Staff's proposed condition in Case Number WA-2023-0450, in which the Commission considered Confluence's acquisition of systems from Chevron/Sierra Land Company, LLC; Brussels Valley Estates, Inc.; and Mapaville Meadows.

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