

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the application of Missouri-American)
Water Company for approval of its acquisition of the) Case No. WM-93-255
common stock of Missouri Cities Water Company.)

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HEARING

EXAMINER: Joseph A. Derque III

REPORT AND ORDER

Procedural History

On March 4, 1993, Missouri American Water Company (MAWC), an operating public utility and Missouri corporation subject to regulation by the Public Service Commission, filed an Application with the Commission for approval to perform a stock purchase agreement in which MAWC will acquire 100 percent of the common stock of Missouri Cities Water Company (MCWC). MCWC is an operating public utility subject to regulation by the Commission and currently furnishing water services to the public in and adjacent to the cities and communities of Brunswick, Mexico, Parkville, Platte Woods, Houston Lake, Lake Waukomis,

Riverside, St. Charles, St. Peters, and Warrensburg, and in parts of the unincorporated areas of Platte County and St. Charles County, all in the State of Missouri.

On March 9, 1993, the Commission issued an order specifying that notice should be given of the proposed transaction per Commission rules and, in addition, specifying a deadline for intervention for all appropriate parties of April 9, 1993. On April 16, 1993, the Commission granted intervention, upon application, to the Cities of Mexico, St. Peters, St. Charles, and O'Fallon, Missouri.

A public hearing was held in this matter in St. Peters, Missouri, on June 1, 1993, and the evidentiary hearing was held at the Commission offices on June 4, 1993. A briefing schedule was agreed to by all parties, and this matter was finally submitted to the Commission on July 12, 1993.

Findings of Fact

The Missouri Public Service Commission, having considered all competent and substantial evidence upon the whole record, makes the following findings of fact.

MAWC, the purchaser, is a regulated public utility in the State of Missouri, and is a corporation organized and existing under the laws of the State of Missouri. MAWC owns and operates regulated public water systems in and adjacent to the Cities of St. Joseph and Joplin, Missouri.

MCWC, the seller, is also a public utility regulated by the Commission, and currently owns and operates public water systems as stated above. On January 30, 1993, MAWC entered into a contract with Consolidated Water Company (Consolidated) to purchase 100 percent of the common stock of MCWC, all held by Consolidated, for the price of \$15,700,000.00 to be adjusted pursuant to the agreement at date of closing. Consolidated is the parent corporation of MCWC.

MAWC, in its testimony, states that it has had a long-standing acquisition policy and continuously seeks out opportunities to expand its system. MAWC maintains that, by acquisition, it adds economies of scale to its existing operations and, in addition, strengthens the financial capability of the entire system. A resulting benefit from this type of relatively aggressive acquisition policy is the ability to better meet its public service obligations, particularly in the area of improvement of the infrastructure of the water service system.

MAWC maintains that the MCWC system is a natural acquisition for MAWC, based on the fact that MAWC presently serves several such communities in the same general area, and the acquisition contains several potential growth areas. MAWC represents that the potential growth will assist in facilitating what it admits is large capital expenditures facing both MAWC and MCWC. These capital expenditures are in the area of expansion construction, increased capacity, and repair or replacement of existing physical plant.

MAWC anticipates that the proposed purchase will result in an increase in size, not quite doubling the holdings of MAWC, and therefore, should, according to MAWC, result in lower debt costs, attracting more purchasers to larger bond issues.

The Commission finds that MCWC, the seller, did not wish to sell its system piecemeal, preferring to offer and sell its entire corporate stock, as opposed to physical plant, to include company holdings in Missouri, Michigan, Indiana, and Ohio. MAWC is proposing to pay \$15,700,000.00 for the acquisition, which by all accounts represents a market to book ratio of 1.6 times. MAWC testifies that the cost for each acquired MCWC customer would be approximately \$880.00, which is significantly less than the current cost of adding a new customer to MAWC's existing system.

Also, in its testimony, MAWC frankly admitted that, while MCWC will be treated as a subsidiary of MAWC at the time of purchase, both a merger and possible rate restructuring would, in all likelihood, be requested within a year.

Finally, MAWC stated it was well aware that the development, expansion, and maintenance of the existing infrastructure is and will be vital to the continued economic growth and vitality of the communities affected by the proposed purchase, while also stating it had performed no detailed long-range study of the MCWC system.

The Staff of the Commission offered testimony from two individuals, those being Mr. Scott A. Moore, Financial Analyst, and Mr. Doyle Gibbs, Regulatory Auditor. Mr. Moore testified that he reviewed the proposed capital changes, pro forma financial ratios, and the reasonableness of the proposed purchase price in ascertaining whether the proposed sale may be detrimental to the public interest. Mr. Moore stated that, after the foregoing review, it was his opinion, based on analytical review, that there was no evidence that the public interest would be disserved by the proposed sale.

Mr. Moore continued by stating that the proposed purchase price, \$15,700,00.00, reflects a market-to-book value ratio of 1.50 times. Mr. Moore stated that the current ratio generally for the pricing of water companies is approximately 1.51 times book value and that, therefore, the purchase price appears to be reasonable, including the premium paid over book value.

Mr. Gibbs' testimony contained no recommendation in regard to the proposed sale, but concentrated largely on the anticipated merger of MAWC and MCWC as a result of the proposed sale, accounting treatment of the acquisition costs, and possible resulting rate impact. In attempting to quantify the potential cost impact of the proposed sale, Mr. Gibbs stated the following:

"Based on the total costs allocated by AWWSC, [American Water Works Company, holding company for MAWC] to its operating companies during 1992 and the change in allocation

factors as a result of the proposed acquisition, MAWC's total costs would increase. However, because of a larger customer base with the inclusion of MCWC, the cost per customer of the service company could actually decrease by as much as twenty percent."

Testimony was also filed by the Office of Public Counsel in this matter. The Office of Public Counsel took no position on the main issue in this case. The Office of Public Counsel did, however, express concern, along with the Staff, regarding any anticipated acquisition adjustment as a result of the possible merger of the buyer and the seller. The Office of Public Counsel objected to any decision in this case requiring the ratepayers to bear any costs related to this stock purchase in the form of increased rates. While the concerns of the Staff and the Office of Public Counsel in this regard are secondary to the central issue, the Commission will take note of them in its findings and order.

While four municipalities affected by this proposed purchase were granted intervention, only two, the City of St. Peters and the City of Mexico, offered testimony at the evidentiary hearing and submitted subsequent briefs. As testimony and argument by the intervening municipalities was essentially in concert, the position of the intervenors will be summarized, with differences noted where appropriate.

The intervenors argued that the Commission should deny the Application for Approval to Purchase Stock because 1) a rate increase to acquire the stock or to pay for the cost of a possible merger would be detrimental to the public interest, and 2) the Commission has failed to consider the impact on the ratepayer of the proposed transaction. The intervenors presented substantial testimony attempting to support these propositions at both the public and evidentiary portions of the proceeding. A summary of this evidence will suffice for this order.

The intervenors, and in particular, the Cities of St. Charles, O'Fallon, and St. Peters, represented largely by the City of St. Peters, alleged that the proposed transaction was detrimental to the public interest and the interest of ratepayers in that the various municipalities, in combination or singly, could operate the various systems in a more economical and efficient fashion and have the technical expertise and resources to better serve customers in the near and long-range future. It was clear from the testimony that all four intervening municipalities have attempted and have the present intent of purchasing the physical plants in and contiguous to their respective cities and incorporating them into their current systems.

Testimony was presented specifically by the City of St. Peters regarding the fact that its municipal water rates were currently lower than those of MCWC and that its planning, together with that of St. Charles and O'Fallon, was of substantially longer range than that of MAWC in terms of anticipating future growth and resulting load on the system.

Substantial emphasis by the intervenors was placed on the anticipated merger of MAWC and MCWC, a possible rate increase, and the potential absorption of the cost of the sale and anticipated merger by the ratepayers, thereby causing a detrimental effect not only on the ratepayers, but on the economic development of the respective communities represented.

Finally, the intervenors maintained that the more economical and viable alternative should be the piecemeal sale of the various individual water systems to the various municipalities, as that would have the least detrimental effect on the public.

The Commission finds that, in the testimony at both the evidentiary and public portions of the hearing, it was clear that one, if not all four, of the intervenors had tendered unsuccessful bids to MCWC for their respective portions of the physical plant of MCWC. This was in spite of the fact that MCWC made it

clear at the outset that it wished to sell 100 percent of its stock in its holdings nationwide, or none at all. In addition, it was clear that one offer for only a portion of the physical plant in the State of Missouri by one or a group of intervenors was approximately 50 percent more than the entire \$15,700,000 purchase price offered by MAWC for 100 percent of the stock in MCWC nationwide. Further, testimony indicated that even though some municipal rates are currently lower than nearby MCWC rates, at least one such municipal water system was, in truth, subsidized by taxpayer funds other than water revenues. It was also pointed out in cross-examination that the proposed purchase of a local system from MCWC for a sum in excess of \$20,000,000 was to be financed through the passage of a large bond issue. Lastly, it was the present intent of the City of St. Peters to exact a surcharge of \$5 or \$10 monthly on each customer acquired outside the city limits as the result of its purchase of the local system.

The Commission found no evidence indicating MAWC or MCWC, both large operating companies and both already regulated by the Commission, were unable or incapable of providing safe and adequate water service. Nor was any evidence presented to indicate either company to have any current service difficulties. No substantial evidence was offered to indicate that the public will suffer any negative effect as the result of this stock purchase. In fact, evidence exists to show that some positive result will occur, that being an improved financial position allowing repair and expansion of aging infrastructure.

The above evidence indicates to the Commission that, aside from the issue of whether the purchase by MAWC is not detrimental to the public interest, a sale of the various contiguous physical plants to municipalities would not create a "free lunch," but spread the burden of the purchase to the taxpayers within and customers outside the various municipal boundaries.

Regardless, the threshold issue which must be decided by the Commission is whether or not to approve the proposed purchase. Should the Commission fail to approve the purchase, the status quo will continue in regard to the operation of both MCWC and MAWC. The Commission has no option in this case regarding any sale of physical plant to any intervenor.

Should the Commission approve the proposed purchase of stock, the intervenors are in no different legal position in regard to the piecemeal purchase of physical plant than they were before the proposed stock sale. The Commission, in light of this fact, is at a loss to understand what the intervenors would gain by blocking this transaction.

For the above reasons, therefore, the Commission finds the arguments presented on behalf of the intervenors to be unconvincing. The Commission would add, as this was of concern to the intervenors, the Staff, and the Office of Public Counsel, that the issues of the potential merger of MCWC and MAWC, the responsibility for the resultant costs of acquisition, and any resultant rate increases, are not before the Commission in this case, and no finding will be made in that regard.

The principal question before the Commission, which the Commission must decide, based on substantial and competent evidence contained in the record as a whole, and in accordance with the controlling rule in this case, 4 CSR 240-2.060(7), can be stated as follows: "Is the proposed sale of 100 percent of the common stock of MCWC to MAWC not detrimental to the public interest?" Although this phrase is somewhat awkward, both the rule and supporting case law, cited by several parties to this action, support this phraseology. See *State ex rel. City of St. Louis v. Public Service Commission*, 73 S.W.2d 393 (Mo. banc 1934); and *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466 (Mo. App. 1980). In addition, the initial burden of proof is clearly on MAWC to show that the

stock acquisition is not detrimental to the public interest, (4 CSR 240-2.060(7)).

In Case No. EM-91-290, in the matter of UtiliCorp United and Colorado Transfer Company, the Commission created a supplemental set of standards for acquisitions and mergers.

Finally, in *State v. PSC*, 73 S.W.2d at 400, the Court states:

"the respondents found that the public would not be affected by the transfer of the stock. The owners of this stock should have something to say as to whether they can sell it or not. To deny them that right would be to deny them an incident important to ownership of property. *City of Ottawa v. Public Service Commission*, 130 Kan. 867, 288, p. 556. A property owner should be allowed to sell his property unless it would be detrimental to the public."

The Commission finds that MAWC has shown, by substantial and competent evidence, on the record, that the proposed purchase of 100 percent of the common stock of MCWC is not detrimental to the public interest. In addition, for reasons as set out above, the Commission finds that no other party to this transaction has shown, by the weight of the evidence, some detriment to the public as a result of the sale. Therefore, the Commission will approve this transaction.

In regard to the additional standards as set out by the Commission in the *UtiliCorp* case, *supra*, it is the opinion of the Commission that MAWC has satisfied those portions which apply to acquisitions in its Application, attachments, and direct testimony. The Commission would note that, in this specific case, MAWC has proposed no rate increase, change in customer service, or alteration in any way of the service being currently provided by MCWC, other than a possible savings in expenses to the operating company as a result of more efficient professional and staff services to be provided by an affiliate of MAWC.

Finally, the Commission emphasizes that the only issue before it in this case is the approval or rejection of the proposed sale of stock. The

Commission takes no position on the prudence or value of the acquisition, any anticipated acquisition adjustment, rate increase, or merger of the two systems. These issues must be dealt with at the appropriate time, and in the appropriate case.

Conclusions of Law

The purchaser, MAWC, and the seller, MCWC, are public utilities under the jurisdiction of the Commission, regulated generally by Chapter 393, RSMo 1986. Specifically, the proposed sale of one hundred percent (100%) of the common stock of MCWC to MAWC is controlled by Section 393.190(2), RSMo 1986, which states in pertinent part:

"No such corporation shall directly or indirectly acquire the stock or bonds of any other corporation incorporated for, or engaged in, the same or a similar business, or proposing to operate or operating under a franchise from the same or any other municipality' neither shall any street railroad corporation acquire the stock or bonds of any electrical corporation, unless, in either case, authorized so to do by the commission."

The principal issue before the Commission, based on substantial and competent evidence contained in the record as a whole, and in accordance with the controlling rule in this case, 4 CSR 240-2.060(7), can be stated as follows: "Is the proposed sale of 100 percent of the common stock of MCWC to MAWC not detrimental to the public interest?" See *State ex rel. City of St. Louis v. Public Service Commission*, 73 S.W.2d 393 (Mo. banc 1934); and *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466 (Mo. App. 1980).

In addition, the initial burden of proof is on MAWC to show that the stock acquisition is not detrimental to the public interest. In this regard and in pertinent part 4 CSR 240-2.060(7) states:

"Applications for authority to acquire the stock of a public utility shall include . . . ; . . . reasons why the proposed acquisition of the stock of the public utility is not detrimental to the public interest."

In Case No. EM-91-290, in the matter of UtiliCorp United and Colorado Transfer Company, the Commission created a supplemental set of standards for acquisitions and mergers, those being:

- "a. All documentation generated relative to the analysis of the merger and acquisition in question must be maintained.
- b. The Company must present an estimate of the impact of the merger on its Missouri jurisdictional operations.
- c. The Company must provide an assessment of the relative risk regarding items that impact its Missouri operations.
- d. The Company must propose assurances or conditions that will address the overall merger components that pose the risk of being detrimental to the Missouri public interest."

In the above-stated case, in Ordered Paragraph No. 7, the Commission stated, "that future applications involving acquisitions and mergers shall be subject to the four conditions outlined in this order."

Finally, in *State v. PSC*, 73 S.W.2d at 400, the Court states:

"the respondents found that the public would not be affected by the transfer of the stock. The owners of this stock should have something to say as to whether they can sell it or not. To deny them that right would be to deny them an incident important to ownership of property. *City of Ottawa v. Public Service Commission*, 130 Kan. 867, 288, p. 556. A property owner should be allowed to sell his property unless it would be detrimental to the public."

The Commission therefore finds that the application by MAWC to purchase one hundred percent (100%) of the stock in MCWC should not be denied unless good reason exists to do so. The Commission further finds that substantial and competent evidence exists, on the record, to support the Commission's finding that the proposed purchase is not detrimental to the public interest.

The Commission finds that the additional standards prescribed by the UtiliCorp case, *supra*, which apply to acquisitions have been satisfied by MAWC for purposes of this case.

Therefore, for the above reasons, the Commission finds that the proposed stock purchase, as set out in detail in the application and attached

exhibits, and incorporated herein by reference as if fully set out as Attachment A, is reasonable, not detrimental to the public interest, and is therefore approved.

IT IS THEREFORE ORDERED:

1. That the proposed stock purchase by and between MAWC, the purchaser, and MCWC, the seller, wherein MAWC has proposed to purchase one hundred percent (100%) of the common stock of MCWC as fully set out in Attachment A hereto, is hereby approved.

2. That the Commission makes no finding, and takes no position on the value, for ratemaking purposes, of the stock acquired, nor in the value placed upon said stock by either the seller or the purchaser. Furthermore, the Commission reserves the right to consider the ratemaking treatment to be afforded this transaction, and its resulting cost of capital, in any later ratemaking proceeding.

3. That the Commission specifically makes no finding, and takes no position in regard to the treatment, for ratemaking purposes, to be afforded any acquisition cost incurred in this transaction. The Commission reserves the right to consider, in full, any potential merger, and resulting costs, which might be contemplated as the result of this transaction.

4. That MAWC will fully inform the staff of the Commission as to the completion and final purchase price of the approved transaction, and will promptly file all appropriate documentation in association therewith.

5. That, upon completion of this transaction, MAWC will file with the staff of the Commission a verified report reflecting all journal entries recording the creation and financing of this transaction, which report shall be verified by the appropriate MAWC official.

6. That this order shall become effective on August 10, 1993.

BY THE COMMISSION

Brent Stewart

Brent Stewart
Executive Secretary

(S E A L)

Dated at Jefferson City, Missouri,
on this 30th day of July, 1993.

Mueller, Chm., McClure, Perkins,
and Crumpton, CC., Concur and certify
compliance with the provisions of
Section 536.080, RSMo 1986.

Kincheloe, C., Absent.