BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of EMC of St. Charles County, LLC for a Certificate of Convenience and Necessity Authorizing it to participate in the Ownership, Operation, Maintenance, Removal, Replacement, Control and Management of a Sewer System in St. Charles County, Missouri.	))))))	**Case No. SA-2007-0373**

DISSENTING OPINION OF COMISSIONER ROBERT M. CLAYTON III

This Commissioner dissents from the Order Granting a Certificate of Convenience and Necessity to the applicant for public sewer service. As stated in the filing by the Office of Public Counsel, "the Commission should be aware that [the lack of well defined answers] may cause significant problems in future rate cases."[1] This Commissioner agrees. While the arrangements associated with this Order are much improved from the original proposal, questions remain that must be answered before any new small water or sewer company should be certificated by this Commission.

The Commission has been faced with many difficult issues involving small water and sewer companies. They are the smallest of the Commission's regulated entities and have been created in many instances by developers organizing new subdivisions. Because of the need for water and sewer service in areas of new construction, developers have given the enormous responsibility of providing utility service that is critical to the health and welfare of customers to untrained and unskilled contractors. Clean, potable water is an absolute necessity and citizens

[1] SA-2007-0373, Public Counsel's Response to Staff Recommendation.

rely on government agencies, including the PSC, to ensure a high-quality product emerges from the tap. Sanitary sewer service, likewise, is equally important for citizens. These services are generally taken for granted and customers expect that the service will work without fail.

This Commission, time and again, has devoted significant resources to addressing the failures of small water and sewer utilities. The list of pending and concluded cases involving problem utilities reaches all regions of the state. The causes for such failures include lack of ability or training, lack of funds, lack of interest, poor PSC policy and inattention. Attempts by the Commission to correct poor performance usually involve a number of bad options to fix that which was poorly designed or planned from the start. Receivership, injunctive relief, bankruptcy and penalty actions have absorbed key personnel and usually result in all parties and customers being unhappy.

In this instance, the original application involved the certification of a new sewer company to operate in St. Charles County for a subdivision that currently has no residents. The sewage treatment facilities were to be owned and operated by the applicant while the pipes and mains as well as other plant would be owned and controlled by a newly-formed "homeowners' association." In addition, the evidence established that a separate "homeowners' association" would operate the water facilities in the subdivision. It is relevant to note that as of the date of issue of the Report and Order that no "homeowners," other than the developer, exist for any of the three of the proposed entities.

While the original proposal was withdrawn from consideration and later amended, this Commissioner feels compelled to urge his colleagues to oppose such a proposal in future cases. The concept of dividing the plant necessary to provide safe and adequate service into two pieces would have been a mistake. The applicants desired to have half of the infrastructure under the

jurisdiction of the Commission, while the other half would lie beyond our control in a so-called "homeowners' association." This Commissioner questions the policy of endorsing an arrangement that splits up control over essential pieces of the system without clear guidance on how future issues will be addressed, such as who will bear certain costs or whether remedies are in place in the event of lack of cooperation. Further, questions come to mind regarding scenarios of developer withdrawal, insolvency, lack of development in the subdivision or overdevelopment. Because of the amended proposal in this case, this is no longer a problem.

This Commissioner urges his colleagues to step back and consider the implications of the current application as well. First, the operation arrangement among the developer, the operator and its parent organization is not clear. Public Counsel has raised concerns regarding the confidential nature of a contract among the entities and concerns for future rate making treatment. Any agreement among the entities must be part of the review by the staff in determining whether such a CCN is in the public interest.

Second, the record is devoid of any legal analysis regarding the presence of an unregulated water "homeowners' association" in this transaction. Traditionally, this Commission has avoided asserting jurisdiction over homeowners' associations because of their non-profit nature and the opportunity of ratepayer participation through elected boards and directors. However, since this is a new development without a single house occupied, there are no "homeowners" to manage or govern the association. The developer will be the only vote and will control the entire water distribution system. This Commissioner questions whether a developer standing alone meets the definition of a "homeowners' association." By implicitly approving this arrangement, this Commissioner is concerned that the Commission will be placing its stamp of approval on the legal nature of the association. It is unclear whether the

"homeowners' association" by-laws provide future customers with the full opportunity of participation to stand as "regulators" in the event of disagreement with the developer. There is a strong argument that a developer standing alone in managing and owning the water system actually acts as a utility subject to and in need of regulation. The Commission has the ability to influence the nature of the arrangement and should consider the implications of the water homeowners' association structure while it still has jurisdiction over all the parties comprising it.

Lastly, this Commissioner raises the concern mentioned previously by colleagues that relates to future rates or the possible future sale of the system. This case may present a reasonable solution to addressing the development of a new water or sewer company with developer involvement by establishing a reasonable rate base and rates of the company. Typically, when a developer establishes a utility company to serve residents of a new subdivision, it may contribute plant to the company through some sort of conveyance. Because the utility does not actually pay for the plant, its cost does not get added to rate base and the utility, obviously, will not recover a cost that it did not incur. However, with large amounts of contributed plant in a system, rate base will be lower than it otherwise would have been, which, in turn, means rates will be lower than if the utility had made a direct investment. Customers enjoy this benefit until such time as the company needs an increase in rates to cover expenses and make investments of new capital. Rates will not be able to rise unless the new plant is put in service. For many small operators, this causes an extreme hardship which has, in the past, led to abandonment of systems. The new infusion of capital with corresponding higher rates may also cause customers to experience "rate shock."

Rate base is established first through assessing plant in service, less the reserve for depreciation and contributed plant, multiplied by an appropriate rate of return. Expenses,

depreciation, and applicable income taxes are added to the return on investment in determining the revenue requirement. Commissioners have raised these concerns because rates may be artificially low or may not have any connection with a cost of service. Further, there may be insufficient incentive or revenues for additional plant investment. Most relevant in recent years, however, are instances involving the sale of a small utility or forced receivership where the book value of the company may be negligible, creating a request for inclusion of acquisition premiums in rates. The Commission has generally denied such requests – and with good reason.

It appears, in this case, that the transactions will include developer or operator investments with subsequent "purchases" by the utility after 100 customers are taking service. Those "purchases" may provide a mechanism for plant to be placed into service with corresponding rate base treatment providing an opportunity for utility returns. The mechanism will also permit rates to more accurately reflect the true cost of service. Hopefully, this transaction structure will forestall future problems with questionable service and the need to transfer the system to new owners. These new arrangements should be monitored and evaluated for effectiveness at assuring the statutory mandates of "safe and adequate service" at "just and reasonable rates."

For the foregoing reasons, this Commissioner dissents.

Respectfully submitted,

Robert M. Clayton III
Commissioner

Dated at Jefferson City, Missouri,
on this 11th day of March 2008.