BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri-American Water Company for a Certificate of Convenience and Necessity Authorizing it to Install, Own, Acquire, Construct, Operate, Control, Manage and Maintain a Water System and Sewer System in and Around the City of Eureka, Missouri	)))))))	**Case No. WA-2021-0376**

STAFF'S REPLY BRIEF

COMES NOW Staff of the Missouri Public Service Commission (Staff), through counsel, and files *Staff's Reply Brief.*

1. The Commission is required to make a public interest determination under §393.170, RSMo, even though MAWC elected to use the procedures of §393.320, RSMo to acquire the Eureka water and sewer systems and set rate base.

MAWC claims that the legislature expressed the public interest through the appraisal statute so that there is no need for the Commission to make an independent public interest determination.[1] There is nothing in the appraisal statute about public interest, and MAWC does not point where it is. From its title to its last subsection, the plain language of §393.320, RSMo establishes that it is procedural. For example, the law's title is: "Acquisition of small water utilities, establishment of ratemaking rate base, procedure." The first sentence after the definitions states:

> The procedures in this section may be chosen by a large water public utility, and if so chosen shall be used by the public service commission to establish the ratemaking rate base of a small water utility during an acquisition.[2]

The last subsection states:

> This section is intended for the specific and unique purpose of determining the ratemaking base of small water utilities and shall be exclusively applied to large water public utilities in the acquisition of a small water utility. This section is not intended to apply beyond its specific purpose and shall not be

[1] *Missouri-American's Initial Brief*, P. 3, 11. (Feb 18, 2022).
[2] §393.320.2., RSMo

> construed in any manner to apply to electric corporations, natural gas corporations, or any other utility regulated by the public service commission.[3]

Section 393.320, RSMo contains the words "procedure" or "procedures" at least three times. Public interest or public service are not mentioned once.

In addition to the required necessary or convenient for the public service finding required by §393.170, RSMo, the public interest is addressed in the fifth Tartan factor. Staff consistently stated that for this transaction, MAWC satisfies the first four Tartan factors.[4] MAWC cites the Commission's decision in *In re Tartan Energy*[5] for the proposition that positive findings for the first four Tartan factors will, in most instances, support a public interest finding that the transaction is in the public interest and therefore, the Commission should find that this transaction is in the public interest. The Commission has also stated that the public interest finding of §393.170, RSMo is separate from consideration of the Tartan factors:

> While the *Tartan* factors are frequently cited in Commission decisions regarding applications for certificate of convenience and necessity, they are merely guidelines for the Commission's decision, and are not part of the legal standard set forth by the controlling statute. Moreover, the *Tartan* decision concerned an application for a certificate to provide natural gas service to a particular service area. As a result, the described factors are not precisely applicable to Empire's applications to construct the Wind Projects. Nevertheless, they provide some guidance and are specifically referenced in the list of issues set forth by the parties for resolution by the Commission.[6]

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[3] §393.320.8, RSMo.

[4] Ex. 101, *Staff Recommendation*, P. 26-27, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).

[5] *In re Tartan Energy Co.*, 3 Mo. P.S.C. 3d 173, 177 (Sept 16, 1994).

[6] *Report and Order*, EA-2019-0010, *In the Matter of the Application of the Empire District Electric Company for Certificates of Convenience and Necessity Related to Wind Generation Facilities*, P. 31-32 (June 19, 2019).

In other words, the Commission stated that it must consider §393.170, RSMo when determining whether to award CCNs, because it is the controlling statute.

All five Tartan factors are relevant to whether the Commission should grant MAWC a CCN for the Eureka water and sewer systems, in part due to the appraisal statute's "unique purpose."[7] MAWC seeks to purchase the Eureka utilities and set rate base in an untraditional manner that deserves public interest consideration. Additionally, because this is the Commission's first opportunity to substantively consider the appraisal statute's parameters, the Commission should take a more expansive approach, with specific consideration of the public interest.

MAWC also implies that the Commission should feel compelled to accept this transaction, because Eureka voters voted to sell their utilities for $28 million[8] and Mayor Flowers does not believe they can be sold for less.[9] But MAWC's existing customers, some of whom will be asked to pay the $28 million purchase price, did *not* vote on the acquisition. That is why it is of material importance that the transaction be subject to Commission approval. Neither the ballot language, nor it appears, the voter resources, disclosed that the transaction was subject to Commission approval. Furthermore, although Mayor Flowers states that he and the Board of Aldermen have a duty to ensure the utilities are sold at fair market value,[10] the Eureka ordinance dealing with selling city assets does not mention fair market value.[11] The Commission's charge is to ensure safe

[7] §393.320.8.
[8] *Missouri-American's Initial Brief*, P. 21 (Feb 18, 2022).
[9] *Id.* at 5.
[10] *Missouri-American's Initial Brief*, P. 5, 11 (Feb 18, 2022).
[11] City of Eureka Municipal Code, Section 2-77.10 states:

> **Responsible for City Property.**
> The Administrator shall have responsibility for all real and personal property owned or maintained by the City of Eureka. He shall have responsibility for all inventories of such

and adequate service at just and reasonable rates by ensuring that CCNs are granted only when necessary or convenient for the public service, and the Commission should judge MAWC"s application under that standard. And finally, Staff is not requesting that the systems be sold for less than $28 million. Staff states that because the proposed purchase price is substantially higher than the systems' estimated net book value, MAWC's other ratepayers should not subsidize this purchase. MAWC is free to purchase the system for $28 million and have its shareholders cover any amounts above net book value, which is historically how rate base is calculated.

MAWC asks the Commission to not consider whether this transaction promotes the public interest. But as Staff stated in its first brief, although §393.320, RSMo establishes rate base, it does not affect the Commission's authority to determine whether issuing a CCN is necessary or convenient for the public service.[12] Section 393.320, RSMo did not repeal or supplant the Commission's authority under §393.170, RSMo, and MAWC attempts to read meaning into the appraisal statute that is not there. The Commission analyzes whether the transaction promotes the public interest during every MAWC acquisition; there is no reason why it should not do the same in this one. The public interest is an especially relevant consideration here when MAWC chose to use the procedures of the appraisal statute to purchase the Eureka systems in order to set rate base at appraised value.

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property and for the upkeep of all such property. Personal property owned by the City may be sold by the Administrator only with approval of the Mayor and Board of Aldermen. Real property may be sold only when such sale is authorized by ordinance.

City of Eureka, MO City Administrator (ecode360.com)

[12] *Staff's Initial Post-Hearing Brief*, P. 5-7 (Feb 18, 2022).

2. It is inequitable for ratepayers to pay twice for fully depreciated components of the Eureka water and sewer systems, as well as for contributed plant that the City of Eureka received at no cost.

To explain the difference between Staff's estimated net book value and its appraisal, MAWC discusses Staff's deductions for contributed plant and fully depreciated plant. In its calculation of estimated net book value, Staff deducted from its estimated net book value for the water utility $2,901,918 for the Arbors development, which the developer donated to the City of Eureka.[13] The City of Eureka paid nothing for it, but now it expects payment for it. Staff also deducted $5.9 million for the water system and $3.9 million for the sewer system for plant that is fully depreciated.[14] Eureka ratepayers already paid for fully depreciated plant through their water and sewer rates. In its first brief, Staff discussed that it would be inequitable for ratepayers to pay twice for fully depreciated parts of these systems, and it would be a windfall for the City of Eureka to receive payment twice.[15] Additionally, it would be windfalls for the City of Eureka to receive payment for contributed plant that was donated to it and for MAWC stockholders to receive a return on funds they never invested.[16]

The fact situation in *State ex rel. Martigney Creek Sewer Co. v. Public Service Commission* is analogous to this one in that the principle issues involved whether the value of sewer lines the subdivision developer deeded to the utility and the value of a sewer treatment plant built by connection fees the developer paid to the utility could be included in rate base for ratemaking purposes. The Supreme Court of Missouri stated

[13] Tr. 277:15-279:8.
[14] Tr. 280:6-20..
[15] *Staff's Initial Post-Hearing Brief*, P. 7-10 (Feb 18, 2022).
[16] *Valley Sewage*, 515 S.W.2d at 851.

that both were contributed property which could not be included in rate base, because ratepayers had already paid for them:

> By considering the connections fees received after June 1, 1967, as revenue, the PSC has done precisely what it has no strenuously attempted to avoid. It has put into the rate base the value of the sewers (plant) that were built with those connection fees. **The net result is that the customers, having paid for the asset themselves with the connection fees (contributions in aid of construction), are required to pay again by being charged a rate the same as if they (customers) had not purchased the physical asset in the first place.** In *Princess Anne Utilities Corp. v. Commonwealth of Virginia ex rel. S.C.C.*, 211 Va 620, 179 S.E.2d 714 (1971), the first issue was whether contributions in aid of construction were properly excluded in determining the utility company's base for rate-fixing purposes. The utility contended that because the facilities were owned by the company it made no difference from where the facilities or the money to construct them came; that having donated the facilities to serving the public the utility was entitled to be paid at a fair rate for the use of its property. The Virginia Supreme Court disagreed holding at 716:
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> 'In excluding contributions in aid of construction from rate base, the Commission followed, and we think properly so, what is the near-universal rule in public utility rate cases. As Professor Priest says in his work 'Principles of Public Utility Regulation,' Vol. 1, ch. 4, p. 177, 'court and commission decisions holding that contributions in aid of utility construction must be excluded from rate base have been so uniform as probably not to require detailed citation.'
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> 'But aside from the fact that the just-cited rule is the one generally followed, there is another consideration prompting its adoption. The rule is based on principles of fairness. **It is inequitable to require utility customers to pay a return on property for which they, and not the utility have paid.**'[17]

Fair market value is different than net book value. But when analyzing whether this transaction is in the public interest, the Commission may consider whether it is in the public interest for certain ratepayers to pay twice for the same property in order to expand MAWC's portfolio. The Commission may also consider whether the City of Eureka –

[17] *State ex rel. Martigney Creek Sewer Co. v. Public Service Commission*, 537 S.W.2d 388, 394 (Mo.banc 1976) (emphasis added) (citations omitted). See also *State ex rel. Valley Sewage Co. v. Public Service Commission*, 515 S.W.2d 845, 851 (Mo.App.E.D. 1974).

which allowed these systems to fall into noncompliance due to lack of maintenance – should receive payment for property it received at no cost, as well as payment twice for the same plant. And finally, the Commission may consider whether MAWC's stakeholders should earn a rate of return on funds they did not invest.

3. The appraisal is deficient and does not meet the requirements of §393.320, RSMo, because MAWC does not explain why the appraisers valuated the Eureka water system higher on a per customer basis than any of the appraisers' comparable systems, and the appraisers failed to consider the systems' known issues.

As MAWC writes, it previously used the appraisal statute to purchase the systems in Orrick, Garden City, and Lawson.[18] Liberty Utilities (Missouri Water) LLC (Liberty) also acquired the Bolivar water and sewer systems through the appraisal statute.[19] Attached is a spreadsheet comparing the per customer values for the other systems acquired through the procedures of §393.320, RSMo to MAWC's proposed Eureka per customer values. Column F shows each system purchased, or for Eureka, proposed per customer value. MAWC and Liberty used the same appraiser, Joseph Batis, and the same consulting engineer, Kelly Simpson, for all acquisitions. Edward Dinan, Chris Stallings, and/or Elizabeth Goodman Schneider also participated in all appraisals. The spreadsheet's columns G through J show the low, high, average, and median per customer values for all systems' comparables, similar to the information shown on page 70 and 73 of the second Eureka appraisal.

This spreadsheet demonstrates that for completed acquisitions, the purchased per customer value (column F) is either less than or no more than $300 higher than the average and median valuations from the appraisers' comparables (columns I and J). In

[18] *Missouri-American's Initial Brief*, P. 18 (Feb 18, 2022).
[19] Case Nos. SA-2020-0398 and WA-2020-0397.

contrast, MAWC's per customer valuation of $4,500 for the Eureka water system is $1,000 higher than the average ($3,416) and median ($3,528) per customer values from comparables that the appraisers chose.

MAWC is unable to justify a per customer valuation $1,000 higher than the appraisers' own average and median per customer comparables. MAWC touts the appraisers' qualifications,[20] but when the only appraiser to submit testimony was asked several times the basic and obvious question how the appraisers assigned the Eureka water system a value of $4,500 per customer, he summarized his analysis to appraisal is an art, not a science.[21] Mr. Batis agreed that a valuation per customer is the most common way to compare values of utility systems.[22] However, even though this is the metric his profession uses, he could not describe why the Eureka system is more valuable than the appraisers' comparables on a per customer basis.[23]

Accordingly, the Commission has no information before it in order to determine how the appraisers reached an appraisal for the Eureka water utility of $4,500 per customer, nor any basis to determine whether the appraisers' valuation is in the public interest. Mr. Batis did not provide information that would be useful to the Commission, such as a comparison of the comparables' ages, condition, and construction to those of the Eureka water system. Perhaps there were circumstances surrounding the other comparable utilities' sales that might affect their value. The Commission can only guess how the appraisers arrived at their valuation of $4,500 per customer for the Eureka water system.

[20] *Missouri-American's Initial Brief*, P. 13-15. (Feb 18, 2022).
[21] Tr. 137:12-14.
[22] Tr. 137:15-138:9.
[23] Tr. 132:12-137:14.

Also absent from MAWC's initial brief is a description of the systems' condition and discussion whether they meet regulatory requirements, and the fact that MAWC plans to abandon the water system's wells and treatment facility in order to provide a different source of water. The appraisers, relying on an incomplete engineering report, assumed that the Eureka water and sewer systems are in proper working order and have been properly maintained, meeting all regulatory requirements.[24] However, although the systems are not troubled;[25] they have not been properly maintained, do not meet all regulatory requirements, and do not produce water that Eureka citizens care to drink.[26] MAWC is aware of these issues.[27] Mr. Batis testified at the hearing that a property's condition is a factor in determining market value,[28] therefore the appraisals are deficient because the appraisers did not consider known issues.

SUMMARY

The Commission has the opportunity in this case to send signals to large water and sewer utilities regarding what would be helpful to the Commission in making its required public interest determination. Commission guidance will make the process described in the appraisal statute more neutral and transparent, which is short in this case. The second engineering reports and appraisals do not refer to their earlier versions, which suggests that MAWC did not want Staff or the Office of Public Counsel to be aware of the earlier reports, which are at substantially lower valuations. Staff inadvertently

[24] Ex. 3, *Mar 23, 2020 Valuation Report*, P. 12, attached to *Direct Testimony of Joseph E. Batis*.
[25] Ex. 101, *Staff Recommendation*, P. 28-29, attached to *Rebuttal Testimony of Curt B. Gateley* (Dec 3, 2021).
[26] See *Staff's Initial Post-Hearing Brief*, P. 11-13 (Feb 18, 2022).
[27] See *Id.* at 12, 15.
[28] Tr. 102:7-103:4.

became aware of the first Flinn Engineering report.[29] Similarly, MAWC describes that Kelly Simpson of Flinn Engineering became aware of the GIS data and wrote a second report, but MAWC omits that it initiated contact with Ms. Simpson, which triggered production of the second report at higher valuations.[30]

The Commission also has the opportunity in this case to contour what it considers to be a reasonable financial incentive to large water and sewer utilities purchasing small utilities pursuant to the appraisal statute's procedures. To assist the Commission, Staff prepared an estimated net book value for the Eureka systems using the same methodology it has for all other acquisitions. This net book value is usually calculated in collaboration with the company and is incorporated into rate base at the company's next rate case. However, the appraisal statute upends the traditional method of calculating rate base and removes Staff's expertise. The difference between MAWC's appraisal and Staff's estimated net book value is approximately $10.2 million, a difference of 45%. This is beyond the financial incentive reasonably intended by the legislature in enacting the appraisal statute. Because of the disparity between MAWC's appraisal and Staff's estimated net book value – in conjunction with issues concerning the engineering report and appraisal and the fact that ratepayers have already paid for the systems' fully depreciated components – this acquisition is not necessary or convenient for the public interest, and the Commission should not approve it.

[29] The March 23, 2020 appraisal (filed with MAWC's application) refers to the March 16, 2020 Flinn Engineering report. In DR 0015 Staff asked for a copy of the engineering report referred to in the appraisal, and MAWC provided a copy of the January 18, 2020 engineering report. See *Response to December 29, 2021 Order Re the Flinn Engineering Report* (Jan 3, 2022).
[30] *Missouri-American's Initial Brief*, P. 16 (Feb 18, 2022).

Respectfully submitted,

/s/ Karen E. Bretz
Karen E. Bretz
Deputy Director
Missouri Bar No. 70632
Attorney for the Staff of the
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102
573-751-5472 (Voice)
573-751-9285 (Fax)
Karen.Bretz@psc.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been electronically mailed to all parties and/or counsel of record on this 28th day of February, 2022.

/s/ Karen E. Bretz