

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the matter of the Application of Ozark Shores Water)
Company, North Suburban Public Utility Company and)
Camden County Public Water Supply District Number Four)
for an order authorizing the Sale, Transfer and Assignment) Case No. **WM-2015-0231**
Water Assets to Camden County Public Water Supply)
District Number Four and in connection therewith certain)
other related transactions.)

**SUGGESTIONS IN SUPPORT OF
STAFF’S MOTION FOR EVIDENTIARY HEARING**

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Suggestions in Support of its Motion for Evidentiary Hearing*, states as follows:

Introduction

1. On March 25, 2015, Ozark Shores Water Company (“Ozark Shores”), North Suburban Public Utility Company (“Suburban”) and Camden County Public Water Supply District No. 4 (“PWSD”), collectively the “Joint Applicants,” filed their *Joint Application* seeking authority to transfer Ozark Shore’s water system assets used in the provision of regulated utility services to the public to PWSD for \$5,252,781. The transaction also includes the sale by Suburban to PWSD of certain tracts of land and buildings used by Ozark Shores for \$165,000, a transaction that does not require the authority of the Commission.¹

The Governing Standard

2. Section 393.190.1, RSMo., provides that public utilities may not “sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its

¹ Suburban, which is not a Missouri regulated utility, owns all of the outstanding shares of Ozark Shores.

franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public utility, without having first secured from the commission an order authorizing it so to do.”

3. The standard governing transactions of this sort is that “[a] property owner should be allowed to sell his property unless it would be detrimental to the public.”² “In the merger context, a PSC decision will be held unreasonable if the PSC erroneously ignores evidence that “may have substantially impacted the weight of the evidence evaluated to approve the merger.”³

4. As the party with the affirmative of the question, the Joint Applicants bear the burden to show that the standard is satisfied.⁴

5. Who, exactly, constitutes the “public” that § 393.190.1, RSMo., requires the Commission to protect from detriment? “In the absence of a statutory definition or established judicial interpretation, analysis * * * begins with the proposition that the primary rule of statutory interpretation is to give effect to legislative intent as reflected in the plain language of the statute.”⁵ “To discern legislative intent, the Court looks to statutory definitions or, if none are provided, the text's ‘plain and ordinary meaning,’ which

² ***State ex rel. City of St. Louis v. Public Service Com'n of Missouri***, 335 Mo. 448, 459, 73 S.W.2d 393, 400 (Mo. banc 1934); and see Rule 4 CSR 240-3.605(1): “[A] applications for authority to sell, assign, lease or transfer assets shall include: . . . (D) The reasons the proposed sale of the assets is not detrimental to the public interest[.]”

³ ***State ex rel. Praxair, Inc. v. Missouri Public Service Com'n***, 344 S.W.3d 178, 184 (Mo. banc 2011), quoting ***State ex rel. AG Processing, Inc. v. Public Service Com'n of State***, 120 S.W.3d 732, 735 (Mo. banc 2003).

⁴ ***Been v. Jolly***, 247 S.W.2d 840, 854 (Mo. 1952): “The burden of proof in its strict sense [is] . . . that of establishing the affirmative of the ultimate issue, which never shifts throughout the trial but remains upon the party asserting it[.]”

⁵ ***Campbell v. County Commission of Franklin County***, 453 S.W.3d 762, 768 (Mo. banc 2015) (internal citations and punctuation omitted).

may be derived from a dictionary.”⁶ The “public” includes all the members of the community or nation as a whole; and the “public interest” is the “general welfare of the public that warrants recognition and protection.”⁷ For purposes of § 393.190.1, RSMo., “the public” is not simply the ratepayers or any particular group of them. An outcome detrimental to the members of PWSD is “detrimental to the public” within the meaning of the standard.

6. A review of the reported cases considering § 393.190.1, RSMo., suggests that the Commission must conduct an “all relevant factors” analysis just as it does in a general rate case, and that a proposed transaction should be approved only where the public benefits outweigh the likely detriments.⁸

What is a Detriment to the Public Interest?

7. An acquisition premium can be detrimental to the public interest. In one case in which the Commission had refused to consider an acquisition premium, the Missouri Supreme Court stated, “the Commission can determine whether the acquisition premium was reasonable, and it should have considered it as part of the cost analysis when evaluating whether the proposed merger would be detrimental to the public.”⁹ In evaluating whether an acquisition premium is reasonable, the Commission should consider “whether the transaction was at arm's length, if it resulted in operating efficiencies, and if it made possible a desirable integration of facilities.”¹⁰

⁶ *Id.*

⁷ ***Black’s Law Dictionary***, 1242, 1244 (7th ed., 1999).

⁸ ***AG Processing***, *supra*, 120 S.W.3d at 736-737.

⁹ ***AG Processing***, *supra*, 120 S.W.3d at 736.

¹⁰ *Id.*, 120 S.W.3d at 736 n. 15; *citing State ex rel. Martigney Creek Sewer Co. v. Public Service Commission*, 537 S.W.2d 388, 399 (Mo. banc 1976).

8. A decreased credit rating can be detrimental to the public. “The risk of an increased cost of debt is just one factor for the Commission to weigh when deciding whether or not to approve [a] merger[.]”¹¹

9. A rate increase can be detrimental to the public, as can increased costs imposed on ratepayers and “illusory” merger savings:¹²

PSC staff had also testified that their analysis of the merger demonstrated that the expected rate impact on SJLP and MPS customers would be negative. Merger costs potentially assignable to the ratepayers included transaction costs, transition costs and administrative costs. Ninety-three percent of the projected merger savings could have been achieved on a “stand alone” basis without the merger, and there was no plan to assign these savings to the customers. Projected merger savings were, in fact, illusory and PSC staff calculated costs exceeding savings by \$68.9 million during the ten-year period following the merger.¹³

10. Reckless, unethical or otherwise undesirable internal policies and practices can be detrimental to the public:

While the PSC may not have the authority to regulate gift policies, it does have the authority to regulate mergers and to disapprove them if they are detrimental to the public. This Court agrees with Praxair that the presiding officer erred in holding that this evidence was wholly irrelevant to the issue of public detriment. While the material in Praxair's offer does may not move the dial very much, it presents a relevant consideration. It is entirely possible that a particular set of gift and gratuity practices could be relevant to the “detrimental to the public” standard were it to permit unethical conduct. Reckless gift giving also conceivably could increase a public utility's costs, resulting in a higher rate being passed through to the ratepayers. Taking such practices into consideration while evaluating a merger does not rise to the level of dictating the way in which a company should conduct its business.¹⁴

¹¹ *Id.*, at 736-7.

¹² *Id.*, at 736; *Praxair*, *supra*, 344 S.W.3d at 188.

¹³ *AG Processing*, *supra*; and see *Environmental Utilities, LLC v. Public Service Commission*, 219 S.W.3d 256, 266 (Mo. App., W.D. 2007): “The rest of the customers, those absorbed into MAWC's system, could conceivably see the cost of sewer service double. The Commission could well determine that such a sale was detrimental to the public, consistent with the requirement of *Fee Fee Trunk Sewer*, 596 S.W.2d 466, 468 (Mo. App. 1980). The Commission's dismissal was well supported by sufficient evidence in the record and was, therefore, reasonable.”

¹⁴ *Praxair*, *supra*, 344 S.W.3d at 188-89.

11. A transaction that leaves some customers receiving substandard service from a distressed utility can be detrimental.¹⁵

What Possible Detriments Concern Staff in This Proposed Transaction?

12. The possible detriments that concern Staff in this proposed transaction are the purchase price, which exceeds the value of Ozark Shore's net rate base by \$2,681,757; the possibility of rate increases due to the acquisition premium; and the history of an overly-close relationship between Ozark Shores and PWSD, reflected by such facts as shared employees and the use of public employees to perform private activities.¹⁶ Staff's *Memorandum*, filed herein on May 5, 2015, states:

The PWSD and Ozark Shores share an unusual business relationship. Vernon Stump and Roger Sallee were business partners who were instrumental in setting up the PWSD. Roger Sallee was formerly the president of Ozark Shores, and is now the president of the board of directors of the PWSD. Ozark Shores stock is owned by North Suburban, and North Suburban is owned by Robert Schwermann and Sally Stump. Ozark Shores lists Vernon Stump and Brian Schwermann as officers. Currently, employees of the PWSD operate both the Ozark Shores and PWSD systems through a joint labor contract. The intense interrelatedness between the ownership of Ozark Shores and the Board of Directors of the PWSD, combined with the very large acquisition premium, create the appearance of a conflict of interest.¹⁷

The historically close relationship of Ozark Shores and PWSD raise a possibility that the proposed transaction is not, in fact, at arm's length.

¹⁵ *Environmental Utilities*, *supra*, 219 S.W.3d at 266.

¹⁶ At the time of the 2010 rate case of the related utility, Lake Region Water and Sewer, the Commission found that Mr. John Summers served simultaneously as the chief executive of both Lake Region and Ozark Shores, as well as the principal employee of the PWSD. *In the Matter of Lake Region Water and Sewer*, Case No. WR-2010-0111 (*Report & Order*, iss'd August 18, 2010), p. 13. In Lake Region's latest rate case, the Commission found that a clerical employee of the PWSD did the monthly billing for Lake Region's availability fees, which funds were dispersed to private parties resident in Texas and Kansas. *In the Matter of Lake Region Water and Sewer*, Case No. WR-2013-0461 (*Report & Order*, iss'd April 30, 2014), p. 31.

¹⁷ *Staff Memorandum*, p. 3.

13. With their *Response to Staff's Recommendation*, the Joint Applicants provided, as Appendix I, an *Engagement Report* by Boone Partners, LLC, which stated, first, that the agreed purchase price is objectively reasonable and, second, that PWSD will be able to service the debt it intends to acquire to finance the purchase from funds generated by Ozark Shores.¹⁸ The avoided-cost analysis of Ozark Shores' operation, at Exhibit 1 to the *Engagement Report*, as projected for 2015, suggests that PWSD will harvest some \$347,845 from Ozark Shores, on an annual basis, with which to service its new debt. However, this amount includes projected Availability Fees revenue of \$199,670, about 57% of the projected total. Staff points out that it is not at all clear whether this revenue stream would continue if PWSD buys Ozark Shores. In *Zweig v. Metropolitan St. Louis Sewer District*,¹⁹ the Missouri Supreme Court considered a "stormwater user fee" imposed by the Metropolitan St. Louis Sewer District ("MSD") for the "'continuous and ongoing' **availability** of a stormwater drainage system regardless of the weather, and the 'continuous and ongoing' **availability** of its oversight functions regardless of when they are requested or needed."²⁰ The Court concluded that the stormwater user fee was a tax and not a user fee at all and that it could not be imposed except by popular vote.²¹ Like MSD, PWSD is a public governmental body. Unlike a private business, such as Ozark Shores, PWSD is not free to impose whatever fees may strike its fancy upon its members. In the event that the Availability Fees

¹⁸ *Engagement Report*, p. 4: "The additional revenue from the OWSC operations should mitigate and offset the increased debt service burden." *Id.*, p. 6: "Our analysis supported a range of values between \$3,684,855 and \$5,969,067 based on Comparable transactions and using Price/Free Cash Flow, Price/Book Value and Price/Rate Base (using the Rate Base provided). Therefore, we believe that an acquisition price of \$5,200,000 is a reasonable offer price for the assets, obligations, and customer base of OSWC."

¹⁹ 412 S.W.3d 223 (Mo. banc 2013).

²⁰ *Id.*, at 235. Emphasis in the original.

²¹ *Id.*, at 244.

revenue is not available after the transaction, consideration of Exhibits 4A and 4B to the *Engagement Report*, the “Debt Service Illustrations,” show that a rate increase would be unavoidable.

What Should the Commission Do Next in this Case?

14. The Commission should set this matter for hearing, schedule a prehearing conference and direct the parties to file a proposed procedural schedule. Staff has elsewhere pointed out that a hearing is required in this case; a conclusion also reached by the courts.²²

15. The Commission should also grant the *Application to Intervene Out of Time* filed herein on May 20, 2015, by the Attorney General. The participation of the Attorney General in this matter can only be beneficial to the public interest.

WHEREFORE, Staff respectfully requests that the Commission issue an order setting an evidentiary hearing in this case and, preparatory thereto, convene a prehearing conference and direct the parties to file a proposed procedural schedule.

²² *State ex rel. Praxair, Inc. v. Missouri Public Service Com'n*, 344 S.W.3d 178, 186 (Mo. banc 2011): “Section 393.190.1 requires regulated public utilities to obtain approval from the PSC for merger transactions. In evaluating whether to approve such transactions, interested parties are allowed to participate in a contested proceeding before the PSC with many of the trappings customarily associated with adjudications conducted by the courts. In this way, the PSC performs a function that is quasi-judicial in nature”; *Environmental Utilities, LLC v. Public Service Com'n*, 219 S.W.3d 256, 264 (Mo. App., W.D. 2007): “EU contends the Commission failed to hold an evidentiary hearing thereby abridging EU's due process rights. EU argues that the Commission held the January 13 hearing for the sole purpose of narrowing the legal issues; thus, the hearing was insufficient and the Commission did not provide the parties the opportunity to introduce evidence as to the Application. Because the Commission did not hold an evidentiary hearing, EU concludes, the order dismissing the Application was unlawful. * * * Section 393.190, governs the transfer of franchise or property of water and sewer corporations. Under this section a regulated utility proposing a sale of its assets must secure an order authorizing the sale from the Commission. Section 393.190.1. On review of the application, the Commission “shall set the time and place for all hearings and serve notice as required by law.” Mo.Code Regs. Ann. tit. 4, Section 240–2.110(1)(year). Where the action involves mixed questions of law and fact, the Commission may order a joint hearing on any or all of the issues “to avoid unnecessary costs and delay.” Mo.Code Regs. Ann. tit. 4, Section 240–2.110(3).”

Respectfully submitted,

/s/ Kevin A. Thompson

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by First Class United States Mail, postage prepaid, to all counsel of record this 29th day of May, 2015.

/s/ Kevin A. Thompson