

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. SA-2007-0373
EMC of St. Charles County, LLC

FROM: James Merciel – Project Coordinator
Water & Sewer Department
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<u>/s/ James A. Merciel, Jr.</u>	<u>11/02/07</u>
Project Coordinator	Date
<u>/s/ Kevin A. Thompson</u>	<u>11/02/07</u>
General Counsel's Office	Date

SUBJECT: Recommendation Regarding Application for
Certificate of Convenience and Necessity

DATE: November 2, 2007

BACKGROUND

On April 4, 2007 (unless noted otherwise, all dates herein refer to the year 2007), EMC of St. Charles, LLC ("EMC" or "Company") filed an Application with the Commission, seeking a Certificate of Convenience and Necessity ("certificate") to provide sewer service to new development in an unincorporated area in St. Charles County, known as Jaxson Estates.

On April 5, the Commission issued its **Order and Notice** requiring that notice of the Application be sent to the county commission in St. Charles County, members of the General Assembly that represent St. Charles county, and newspapers serving the area. This order also set April 25 as an intervention deadline for interested parties. No applications to intervene were submitted by the established deadline, nor have any been submitted since.

In the same **Order and Notice**, the Commission ordered the Commission Staff ("Staff") to file a recommendation by May 21.

On May 21, the Commission Staff ("Staff") filed its **Motion for Extension of Time** in which it stated that EMC had not yet submitted a feasibility study, and stated its belief that it would be able to file its recommendation 45 days after the feasibility study was filed. The Commission granted the extension by its **Order Granting Motion for Extension of Time**. EMC submitted a **Supplement to Application** on July 25. The Staff, on September 7, filed its **Motion for Additional Extension of Time** stating that the feasibility study submitted by EMC did not show

clearly that the proposal was feasible, and that it needed the additional time to further discuss the issues with EMC, and that it expected to complete its work and file a recommendation by October 15. On October 15, the Staff filed a **Motion for Additional Extension of Time** in which it requested an extension to November 15. On October 18, EMC filed its **Opposition to Motion for Additional Extension of Time** then, on October 19, the Commission issued its **Order Extending Time By Which Staff Shall File its Recommendation**, in which it granted the Staff additional time to file its recommendation, to November 2.

DESCRIPTION OF EMC AND THE PROPOSED SERVICE AREA

As noted at the beginning of this Memorandum, Staff members from the Auditing and Water & Sewer Departments participated in the Staff's investigation of the Application. All Staff participants and the assigned attorney from the General Counsel's Office were provided the opportunity to review and comment on this Memorandum prior to it being filed. Jim Merciel of the Water & Sewer Department created the initial draft of this Memorandum, and comments received from the reviewers were incorporated therein to create this final version of the memo.

EMC is a subsidiary of Environmental Management Corporation, which is an established water and sewer operations management firm that operates water and sewage treatment facilities for utilities nationwide, including elsewhere in the St. Charles area. Environmental Management Corporation itself is a part of a corporation known as the BOC Group. Besides holding itself out as a contract operator, Environmental Management Corporation also offers other services to utilities such as design and planning, financing, and laboratory work. Environmental Management Corporation is directly involved, and will be providing services to, EMC.

The proposed service area is comprised of a development known as Jaxson Estates, which is a new residential and commercial subdivision. There is a potential for approximately 500 customers under the current development proposal. The developer is providing the original financing of the sewage treatment plant, a bio-membrane facility, which is a technologically advanced type of treatment facility. It has a design flow capacity of 150,000 gallons per day, and is approximately a \$2 million project. EMC has an agreement with the developer to take ownership of the sewage treatment plant, and pay a capital recovery cost on a monthly per-customer basis, by the terms of a confidential contract with the developer. EMC will actually own only the treatment facility; the sewer collection system will be owned by the Jaxson Estates Homeowners Association, Inc. (the Association). The Association will be EMC's only customer, although EMC or Environmental Management Corporation will also hold itself out for billing the individual users, which it will be in a position to do along with a contract Environmental Management Corporation has with the Association to provide operations and billing for the Association-owned water system. The Association will be responsible for operating its sewage collection system, which will include pipeline and manhole repairs and responding to blockages and backups. As such, this work and the costs associated with this work

is not included in EMC's proposal. EMC has proposed a rate of \$30 per month per customer for operation of the treatment facility.

STAFF'S FINDINGS & CONCLUSIONS

After a review of the Company's information submitted in its filings, as well as information obtained from discussions and other information submittals, the Staff believes that the requested \$30 per month is reasonable. Since this is a new area of development starting with no customers, and as would be expected, there initially will not be sufficient revenue for this system to be financially viable on a stand-alone basis. Based on EMC's projected unadjusted expenses, which could reflect the actual amount incurred, a deficit would continue, at the \$30 per month rate level, for a five year projection period. However, based on adjustments made to EMC's projections, the Staff believes that EMC will experience operating losses until approximately 110 to 120 houses have been sold, of the ultimate 400 residential equivalent customer level plant design capacity. At that point, approximately year four of the development, it appears that enough rate revenue will be generated at the \$30 rate to offset expenses. However, the Staff's position is based on its experience with expenses generally allowed for other regulated sewer companies in informal rate cases, which are less than EMC's projections, and such levels would be reflected in recommendations in future rate cases. The Staff expects to submit a proprietary copy of the Staff's estimate of expenses and revenue in this case at a later date.

The Staff believes that the concept of capital reimbursement to the developer is appropriate, since EMC will have no investment initially, before customers exist. EMC will, over time and as refunds are paid to the developer, create investment (rate base), allowing a basis on which a return on investment may be included in rates. The Staff believes, however, that neither it nor the Commission should be bound, for ratemaking purposes, by the specific terms of the confidential contract for capital recovery. A specific recommendation regarding capital recovery should be made in the next case.

EMC will need to apply depreciation accrual to those facilities that it owns when it begins providing utility service, and the Staff thus recommends the depreciation schedule, shown on Attachment 1, be approved. The Staff will expect EMC to properly book its plant facilities, and apply the appropriate depreciation rates to each plant account. For future ratemaking, the Staff will recommend that the total of any capital recovery amounts paid by EMC to the developer that exceed the net plant balance not be included as rate base.

As a start-up operation with uncertain expenses and investment, the Staff will recommend that EMC file a rate case immediately after 100 customers are connected. The Staff believes that EMC may be supported by the parent corporation. Any utility, even another established sewer utility, would need to deal with operations costs exceeding revenue from within the specific area.

The treatment plant is being constructed under a permit issued by the Missouri Department of Natural Resources (DNR). Environmental Management Corporation will provide the physical plant operations for EMC. DNR has stated to the Staff that EMC is adequately operating other facilities with which it is involved.

Based upon its review of the documents and information provided by EMC and the Staff's familiarity with the Company, this system, the area, and its analysis of the "*Tartan Energy Criteria*" as discussed in the following section, the Staff has concluded that EMC's request for a certificate should be granted.

THE TARTAN ENERGY CRITERIA

Staff analyzed the Company's ability to meet the *Tartan Energy* criteria, as slightly modified by the Staff, as has historically been done in evaluating service area certificate applications. Conclusions regarding this matter are set out below.

Is there a need for the proposed service, and is there a need for the Company to provide the proposed service? There is a need for service in the requested area in that development is under way. Regarding the matter of whether there is a need for the Company to be the entity providing service, this area is remotely located and there are no other sewer systems in proximity. The Staff believes that there is a need for service in the area, and it is logical for the Company to provide the service.

Is the Company qualified to provide the proposed service? The Staff believes that the EMC has demonstrated technical and managerial ability to operate the sewer system, in that it is a subsidiary of an established business that exists specifically for the purpose of undertaking such activity, employs a staff of utility operations professionals, and is in fact operating other facilities in eastern Missouri and elsewhere.

Does the Company have the financial ability to provide the proposed service? The Staff believes that the Company has the financial capability because it is a subsidiary of a parent corporation that operates on a national level.

Is the Company's proposal economically feasible? The Staff believes that providing service in the proposed service area is feasible, though as an area consisting only of new development it will take several years to achieve stand-alone viability. Viability will be achieved unless the subdivision itself is not successful.

Does the Company's proposal promote the public interest? The Staff believes the Company's proposal promotes the public interest because a reliable central sewer system is desirable and necessary for this developing area.

ADDITIONAL MATTERS

The Company will need to keep its books and records in accordance with the Uniform System of Accounts, as is required of all regulated utilities. The Company will also need to prepare and file for approval, a complete new tariff.

The Company, as a regulated utility, will need to comply with obligations including, but not limited to: filing an annual report; paying an annual assessment fee; providing safe and adequate service at just and reasonable rates; complying with all relevant state and federal statutes and rules; and complying with all orders of the Commission.

The Company has no delinquencies with regard to filing its annual reports and paying annual assessments since it is not yet operating as a regulated utility.

The Staff believes that specific conditions are necessary in order for EMC to hold a certificate to provide sewer service. The Staff's recommended conditions are:

1. The utility will exercise all practical efficiencies of scale and economy, such as but not limited to, combined monthly billing for sewer and water service. The water service remains unregulated through the homeowners' association and services are to be contractually provided by an affiliate of the utility.
2. The utility will maintain accurate and timely records, including time cards, for all employees performing tasks for the regulated sewer company. All possible employee time sharing between the sewer and water operations, as well as operations elsewhere in the vicinity of this service area, should be considered in an effort to reduce costs.
3. Within three months of the connection of the 100th house, or three years following the effective date of the order in this case, whichever occurs first, the utility will file an informal rate case under the Commission's established procedures. This case will address the appropriate expenses and rates for service, as well as a capital cost recovery mechanism.
4. All facilities provided by the developer, in accordance with the Application in this case, shall be offset by recording a contribution that will be later offset by utility payments to the developer through a future cost recovery mechanism.

5. A signed operating agreement, consistent with an example that was provided to the Auditing Staff, between EMC and Environmental Management Corporation, will be executed prior to the time the utility begins providing service. This agreement will contain a written provision that allows the Staff of the Missouri Public Service Commission to have access to EMC's books and records to determine the reasonableness of the costs charged to EMC St. Charles.
6. A written signed agreement will be executed between EMC and any affiliate that provides service or charges costs to the utility. The agreement will contain a written provision that allows the Staff of the Missouri Public Service Commission to have access to the books and records of the affiliate to determine the reasonableness of the costs charged to the utility.

STAFF'S RECOMMENDATIONS

Based upon the above, the Staff recommends that the Commission issue an order that:

1. Grants the Company's request for a Certificate of Convenience and Necessity to provide sewer service to the proposed service area;
2. Requires the Company to submit a new tariff for sewer service to be provided within the proposed service area;
3. Requires the Company to maintain its books and records in accordance with the Uniform System of Accounts, including maintaining accurate employee time cards and records of affiliates' payroll and other expenses necessary in performing tasks for the regulated sewer company at actual cost, and properly accounting for plant cost and depreciation as described in the Staff's conditions, above.
4. Requires the Company to file a rate case as recommended by the Staff's conditions, above.
5. Requires the Company to enter into operating agreements, or resource-sharing agreements, that are necessary and appropriate, as recommended by the Staff's conditions, above.
6. Recognizes that nothing in this recommendation or in any order issued by the Commission in this case shall bind the Commission on any ratemaking issue in any future rate proceeding. This includes the specific terms of the confidential contract between the utility and the developer, the inclusion in future rates of any cost resulting from this contract, and EMC's projected costs.

After the Company submits tariff sheets, the Staff will submit an additional recommendation regarding the approval of that tariff.

Attachment 1 Depreciation Schedule