BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Confluence River Utility	)	
Operating Company, Inc.'s Request for	)	
Authority to Implement a General Rate	)	**File No. WR-2023-0006**
Increase for Water Service and Sewer	)	Tracking Nos. YW-2023-0113
Service Provided in Missouri Service	)	and YS-2023-0114
Areas	)	

REPLY BRIEF OF

CONFLUENCE RIVERS UTILITY OPERATING COMPANY, INC.

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Table of Contents

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In the Matter of Confluence Rivers Utility Operating Company, Inc.'s Request for Authority to Implement a General Rate Increase for Water Service and Sewer Service Provided in Missouri Service Areas	))))))	**File No. WR-2023-0006** Tracking Nos. YW-2023-0113 and YS-2023-0114

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COMES NOW, Confluence Rivers Utility Operating Company, Inc. ("Confluence Rivers" or the "Company"), by and through the undersigned counsel, pursuant to the Commission's *Order Granting Motion to Amend Procedural Schedule* and provides this Reply Post-Hearing Brief. On August 29 and September 1, 2023, various unopposed stipulations were filed which limit the number of issues awaiting Commission resolution. As such, the Commission is asked to decide the following issues: (1) Issue 4: Income Taxes; (2) Issue 6: Acquisition-Related Costs; (3) Issue 8: Timesheets; (4) Issue 13: Cost of Capital; (5) Issue 16: Advanced Meter Infrastructure Investments; and (6) 17(d): Operations, Maintenance, and Oversight. Thus, Confluence Rivers submits the attached Reply Brief on those issues awaiting decision.

I. INTRODUCTION

As the Commission is aware, a large portion of the evidentiary hearing in this matter focused on the disincentives to acquire and rehabilitate distressed water systems that were inherent in the positions advanced by Staff and Public Counsel. These disincentives took various forms including: (1) radical changes in positions from previous Confluence Rivers rate cases; (2) recommendations 180° contrary to the views advanced in other states that are more receptive to acquisitions of distressed systems; and (3) deflated cost of capital recommendations that do not reflect the risks inherent in a utility that has always incurred net operating losses. From its positions on the recovery of preliminary acquisition-related costs to normalization of income taxes to third-party operations costs to cost of capital, Staff and Public Counsel have created a regulatory environment in which no utility, not just Confluence Rivers, would feel welcome to acquire distressed systems and be confident that it would ultimately recover the costs of the system rehabilitation.[1]

The following exchange between Commissioner Holsman and Mr. Cox neatly summarizes the problem underlying the positions advanced by Staff and Public Counsel and why they place Missouri at an incredible disadvantage *vis-à-vis* Mississippi, Louisiana, and Texas when it comes to attracting capital for the purposes of rehabilitating distressed water systems.

> Q. Okay. And so I'm -- all of this is leading up to the real primary question I have and that's about the incentive to do this. You obviously have been incentivized enough over the last ten years to execute this business model that you have. We talked previously about rather the treatment of taxes and how that is -- how that would occur would be an incentive or a disincentive to invest in Missouri, whether it's your company or anyone tells who would want to, you know, rescue these distressed systems. In your opinion, first question 1: ***<u>Is there enough of an incentive for -- in terms of the profit motive to continue to invest in Missouri?</u>*** And 2: does the tax treatment incentivize or disincentivize that overall I guess benefit to the investment?

[1] As Confluence Rivers indicated in its Initial Brief, nobody on Staff is concerned with how its positions "would impact future acquisitions." (Confluence Rivers Initial Brief, pages 2-3 (citing to Tr. Volume 9, pages 125-126)).

> A. Yeah. So I'll start with your first question. So the first -- the answer to that is up ***until this general rate case I would say there was enough stable regulatory environment that we were incentivized to continue to buy these systems***. I mean one of the things we say around our company all the time we love what we do. We don't run on love. We have to have profit motive on this whole thing.
>
> But you know it's interesting as you go through the details on this case, since our last rate case we've acquired nineteen systems and ***the Office of Public Counsel has requested a net decrease in revenue***.
>
> So when you get outcomes like that that definitely tells you that hey, ***this state is not welcoming to the type investments we have to make, right***.
>
> So -- and it is even though it is about which states are attracting capital, you know. ***So I've invested a lot more money in Texas, a lot more money in Louisiana***. Some of that is a function of hey, the owners are different people so it's harder to get them to the table but some of that is we understand how fast the investments we recognize. And there is a public policy especially like hey, we know that these symptoms need to be invested collectively, commission staff, environmental regulator and all of that. And we thought we had that here in this state.[2]

Despite the persistent assertions that its recommendations created disincentives for a utility to acquire distressed systems, Staff and Public Counsel stubbornly maintained their positions. Specifically, Staff and Public Counsel recommend: (1) a flow-through approach for income taxes that would exclude any income taxes from rates in this case; (2) the disallowance of preliminary acquisition-related legal and engineering costs associated with ensuring clean title, acquiring easements, system mapping, and system condition assessments; and (3) a deflated cost of capital not reflective of the risk inherent in a utility that has historically suffered net operating losses. On top of all of these positions, Public Counsel then recommends a mammoth disallowance of third-party O&M costs that results in the referenced "net decrease in revenues."

In contrast to the cold shoulder reflected in the positions of Staff and Public Counsel, the Commission clearly sought to explore mechanisms that would attract capital to Missouri for the purpose of acquiring and rehabilitating distressed systems. For instance, Mr. Cox's testimony at

[2] Tr. Volume 9.5, pages 36-38 (emphasis added).

the hearing described the greater attractiveness of investment in Mississippi and Louisiana that results from the positions adopted by those Commissions.

> Q. [Woodsmall] Okay. Let's move to the second part, what the other states do. Let's talk Mississippi. You're familiar with the recent Mississippi rate case?
>
> A. Yes.
>
> Q. Okay. And there, can you tell me -- well, explain first what the mechanism is? You said a regulatory asset. But can you tell us more about what that is?
>
> A. Sure. It's a System Acquisition Regulatory Asset is the -- SARA is the acronym. And it effectively does what I was explaining to Mr. Clizer. For newly acquired systems it tracks revenue less expenses and whatever that negative number is moved to the balance sheet for consideration in future rate proceedings.
>
> Q. And because that's put on the balance sheet it's included in rate base in those other states?
>
> A. Correct.
>
> Q. And the company is allowed to earn a return?
>
> A. Correct.
>
> Q. Okay. Despite that, those regulatory assets in both -- first off, that mechanism is done in Mississippi and Louisiana; is that correct?
>
> A. Correct.
>
> Q. Given that Mississippi and Louisiana have this regulatory asset treatment would acquisitions in those states be viewed more favorably than acquisitions in Missouri if Missouri doesn't have it?
>
> A. Absolutely.[3]
>
> * * * * *
>
> Q. [Commissioner Holsman] So my first question is the SARA that you mentioned. Was that a -- was that a product of a statute that had to be passed in Mississippi and Louisiana to allow those Commissions to book that as a regulatory asset?

[3] Tr. Volume 9, pages 65-68.

A. I don't think it had anything to do with existing statutes. It was part of a conversation with those Staffs about how to continue to do what we had been doing in those states.

Q. So it's your testimony that that was -- that scheme, as it were, --

A. Yeah.

Q. -- was a product of the Commissions and not a product of requiring statute to allow that to occur?

A. That's correct.

Q. Okay. And you view that as -- we use the term incentive -- but as a signal for investors to rescue distressed systems?

A. Absolutely. And certainly in our investor context it is viewed favorably.[4]

Ultimately, after being pushed by the Commission, Staff's Director of Financial & Business Analysis agreed it was not "confined by statute" from taking a similar approach and that the Commission "could do it if you wish to."[5]

While Confluence Rivers would like to eventually explore a similar type of approach with the Commission for use in Missouri, it does not seek such a mechanism in this immediate case. Instead, Confluence Rivers simply asks that the Commission recognize the disincentives inherent in the positions of Staff and Public Counsel and, recognizing that such disincentives will naturally result in Missourians needlessly suffering from water service that is not safe and adequate, reject Staff and Public Counsel's punitive positions.

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[4] *Id.* at pages 68-69.

[5] *Id.* at pages 151-152. Indeed, Staff Counsel agreed with this assessment. ("As the Western District has explained, the Company could have attempted to preserve those losses for later rate recovery by seeking an Accounting Authority Order ("AAO"), but it did not." Staff Initial Brief, page 7 (citing to *Office of Public Counsel v. Evergy Missouri West, Inc.*, 609 S.W.3d 857, 872 (Mo.App. W.D. 2020)).

II. INCOME TAXES

Issue: With respect to income tax –

a. **How should income tax expense be set for purposes of establishing the revenue requirements?**
b. **If the Commission allows Confluence to recover income tax expense in an amount greater than what would be remitted to the IRS in a given tax year, should the excess income tax expense be booked to a deferred liability account that will offset rate base?**

Confluence Rivers Initial Brief, pages 16-22
Staff Initial Brief, pages 4-10
Public Counsel Initial Brief, pages 7-21

As explained in the Confluence Rivers Initial Brief, the issues in this case concerns whether, for purposes of establishing income tax expense, the Commission should utilize tax normalization or flow-through accounting.[6] As explained further in that brief, Staff and Public Counsel's utilization to the flow-through approach for calculating income taxes, after using the normalization approach in all previous Confluence Rivers rate cases, represents a radical change in approach. Further, at a time when Confluence Rivers is attempting to generate revenues so that it can acquire and rehabilitate further distressed systems, Staff and Public Counsel's change in approach denies the Company a significant portion of revenues resulting from this case. Finally, since Staff and Public Counsel's positions are diametrically contrary to those of every other state in which CSWR operates, it places Missouri at a major disadvantage when it comes to the attraction of the limited capital for the purpose of acquiring and rehabilitating distressed water and wastewater systems.

In their initial briefs, Staff and Public Counsel do not deny any of these points. Rather, Staff and Public Counsel make a number of arguments designed to simply reduce the revenue requirement in this case and, as a result, hinder Confluence Rivers' efforts to acquire and rehabilitate distressed Missouri water and wastewater systems. Ultimately, the Commission

[6] Confluence Rivers Initial Brief, page 11.

should reject Staff and Public Counsel's novel use of the flow-through method for calculating income taxes in favor of the time-trusted normalization approach.

A. The Normalization Of Taxes Is Ubiquitous In The Utility Industry

In their initial briefs, Staff and Public Counsel assert that, after they had utilized the normalization approach for calculating income taxes in all previous Confluence Rivers rate cases, the Commission should reverse course and utilize the flow-through approach to calculating income taxes.[7] Staff justifies this change in course on the misplaced notion that Confluence will never have to pay income taxes.[8]

As mentioned, Staff and Public Counsel's position represents a dramatic change in course. Specifically, Staff and Public Counsel utilize the normalization approach, advocated by Confluence Rivers, for all Missouri utilities. Moreover, Staff and Public Counsel utilize the normalization approach in all previous Confluence Rivers rate cases.[9] Furthermore, the normalization of income taxes is consistent with Staff's utilization of normalization approaches for all other utility revenues and costs.[10] Finally, the use of tax normalization, even for utilities that have not opted to recognize accelerated depreciation, is virtually ubiquitous in the utility industry.[11] Indeed, as referenced in the Confluence Rivers Initial Brief, FERC rules mandate the normalization of income taxes.[12] As such, the Staff and Public Counsel's approach is outside the mainstream.

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[7] *See*, Public Counsel Initial Brief, page 7 ("[t]he central question is simply this: should Confluence's NOLs be given "normalization" treatment for ratemaking purposes. The answer to this question is no.")
[8] *See*, Staff Initial Brief, page 5 ("The Company seeks to recover in rates, with respect to Income Tax expense, an amount that is more than it will ever actually pay to the IRS or the Missouri Department of Revenue ("DOR")."
[9] Tr. Volume 9, pages 129-130.
[10] Exhibit 110, Majors Direct, page 5.
[11] "Substantially, all utility companies follow this practice [normalization] and it is required by FERC." James Bonbright, Albert Danielsen & David Kamerschen, *Principles of Public Utility Rates*, page 289 (1988).
[12] 18 CFR §35.24(b)(1)(i) ("A public utility must compute the income tax component of its cost of service by using tax normalization.")

B. The Normalization of Income Taxes Is Not Retroactive Ratemaking

In its Initial Brief, Staff makes the radical suggestion that tax normalization constitutes unlawful "retroactive ratemaking."[13] This suggestion is radical because Staff readily acknowledges that it already normalizes taxes for all Missouri utilities and has used the same approach in all previous Confluence Rivers rate cases.

Staff's assertion represents a fundamental misunderstanding of this issue. While Staff provides little legal discussion to justify for this misplaced conclusion, it appears that Staff believes that, instead of tax normalization, Confluence Rivers is seeking to recover its past net operating losses.[14]

As indicated earlier, while Confluence Rivers may seek to engage the Commission in a discussion regarding the deferral of net operating losses associated with its acquisition and rehabilitation of distressed water and sewer systems, Confluence Rivers is not seeking to recover past operating losses in this case. Instead, as indicated in the previous section, Confluence Rivers is merely seeking to normalize the calculation of income taxes in this case. Much like Staff's normalization of all other expenses, this is not retroactive ratemaking, but rather a method for calculating a current expense.

C. Tax Normalization Is Not An Incentive

In its Initial Brief Staff suggests that the Commission should not utilize tax normalization as an "incentive" for Confluence Rivers' business plan of "purchasing and rehabilitating derelict water and sewer systems."[15] Confluence Rivers agrees. The utilization of tax normalization is not

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[13] *See*, Staff Initial Brief, pages 5, 6-7 ("[T]he Commission may not grant the Company's request because it is frankly illegal as retroactive ratemaking." "[T]he Commission cannot grant the Company's request because it is illegal as retroactive ratemaking.").
[14] In its discussion on retroactive ratemaking, Staff points to past "losses". Staff Initial Brief, page 7.
[15] Staff Initial Brief, page 5.

an incentive. Rather, as explained previously, since all other states utilize tax normalization, Staff and Public Counsel's recommendation to utilize the flow-through approach for taxes would constitute a disincentive when it comes to attracting capital to Missouri. Thus, the utilization of tax normalization would not constitute an incentive. Rather, it would simply represent the status quo and the elimination of Staff and Public Counsel's proposed disincentive. In the event that the Commission wishes to actually create incentives, it should adopt Staff's proposition to increase the return on equity for that purpose.[16]

D. Staff And Public Counsel Alternative Position

Perhaps recognizing the punitive nature of their recommendation and the disincentive it creates for any utility to invest in Missouri, Staff and Public Counsel presented an alternative approach in their surrebuttal testimony. Under that alternative approach, in the event that the Commission continues to utilize tax normalization, Staff suggests that the Commission should create a regulatory liability for the difference between taxes collected in rates and that paid to the IRS and Missouri Department of Revenue.[17] That differences would then be "used as an offset to rate base in future rate proceedings."[18]

Recognizing that it would reestablish the rightful level of current revenues resulting from this case, the alternative position represents a much better approach than Staff and Public Counsel's initial position.[19] That said, however, recognizing that these current <u>revenues</u> come at the cost of future <u>earnings</u>, the alternative approach is still fundamentally flawed.

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[16] Staff Initial Brief, page 8 ("As Staff Counsel suggested at the hearing, an incentive may be awarded via an upward adjustment to the Return on Equity ("ROE"))

[17] Staff Initial Brief, page 10; Public Counsel Initial Brief, pages 20-21.

[18] *See*, Exhibit 123, Bolin Surrebuttal, pages 6-7. *See also*, Exhibit 203, Riley Surrebuttal, page 8.

[19] Tr. Volume 9.5, page 38.

Staff and Public Counsel's alternative position is based on the misplaced premise that the benefits of past net operating losses should inure to the benefit of ratepayers.[20] Specifically, under the alternative approach, any difference between the amount of taxes collected in rates and that paid by the Company would be utilized as a reduction to rate base. The fundamental flaw in the alternative approach, however, is that the benefits of past operating losses should not inure to the benefit of ratepayers. Since net operating losses were created by the Company acquiring systems in which the adopted rates did not cover operating costs,[21] the ratepayers have already benefited from deflated rates. It would be inequitable to then allow ratepayers to again benefit from these net operating losses in either the form of a reduction in current revenues or in a reduction in future shareholder earnings. Rather, since shareholders alone absorbed the entirety of these past operating losses, they alone should receive any associated tax benefits. And, importantly, they should not have to absorb the loss of future earnings simply to receive the rightful level of revenues in this case.

E. Staff's' Audit Was Not Impeded

Perhaps recognizing the fundamental basis for its punitive position, Staff suggests that the Commission should not reward the Company with an "incentive", in the form of tax normalization, because "Staff's audit was impeded in this case." As an initial matter, the utilization of tax normalization is not an incentive. Rather, as discussed earlier, tax normalization is a well-established approach in utility ratemaking utilized throughout the country included every state in which CSWR operates. As such, the utilization of tax normalization would, in part, remove the disincentive created by Staff and Public Counsel's utilization of the flow through method for calculating income taxes.

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[20] Public Counsel Initial Brief, page 7 (". . .the recognition of the benefits created by these NOLs for ratepayers".)
[21] *See*, Confluence Rivers Initial Brief, page 16 for a discussion of the creation of net operating losses.

That all said, Staff provides no evidence for its baseless suggestion that Confluence Rivers "impeded" Staff in its audit. To the contrary, Staff's problems in this audit were entirely caused by its consolidation approach. Under that approach, Staff attempted to compare the cost of service for every Confluence Rivers water and wastewater system. As such, Staff effectively conducted an audit and calculated a revenue requirement for every Confluence Rivers' system.[22] It is not surprising then that Staff struggled with this herculean task. Rest assured, Staff's struggles to accomplish this task was not the result of the Company impeding in its effort. In fact, the Company made every effort to assist Staff in achieving this goal including answering thousands of data requests and, more importantly, voluntarily agreeing to a 15-day extension for the time for Staff and Public Counsel to file their direct testimony.[23] As such, Confluence Rivers implores the Commission not to accept Staff's suggestion that the Company should be punished for Staff's difficulties in conducting its audit by denying it the utilization of tax normalization.

[22] *See*, Exhibit 112.
[23] *See*, *Motion to Amend Procedural Schedule*, filed April 21, 2023.

III. ACQUISITION-RELATED COSTS

Issue: What legal and preliminary engineering costs related to acquisitions and applications for certificates of convenience and necessity should be capitalized?

Confluence Rivers Initial Brief, pages 23-28
Staff Initial Brief, pages 11-14
Public Counsel Initial Brief, pages 22-27

A. Situation Not Analyzed in Regard to Transaction Costs Definition

Staff's Brief, as did its testimony, addresses this issue from the perspective of transaction and transition cost analysis from cases involving regulated electric utilities providing safe and adequate service at the time of the merger. Staff should have reviewed the specific definition of transaction costs and attempted to apply it to the acquisition of small, distressed water and sewer companies. Public Counsel similarly relies on Staff witness Majors definitions derived from *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc. for Approval of the Merger of Aquila, Inc. with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief*, Report and Order, Case No. EM-2007-0374 (Issued July 1, 2008) ("*KCPL/Aquila case*").[24]

The definition of transaction costs cited by Staff in testimony (from the *KCPL/Aquila case*)[25] includes the statement that transaction costs are "not to facilitate the provision of utility service."[26] The definition also states that transaction costs "are not used or useful nor necessary for the provision of safe and adequate service."[27] These aspects of the definition are not cited by either Staff, nor Public Counsel in their briefs.

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[24] Public Counsel Initial Brief, pages 22-23 and Exhibit 129, Majors Surrebuttal, page 4.
[25] Exhibit 129, Majors Surrebuttal, page 6.
[26] *Id*. (emphasis added).
[27] *Id*. (emphasis added).

Staff did not make any attempt to determine whether the individual costs that it disallowed facilitated the provision of utility service or aided in the provision of safe and adequate service.[28] Staff merely relied on the fact that the Commission has routinely denied certain costs as a result of the St. Joseph and Aquila merger cases Mr. Majors cited.[29]

Public Counsel additionally cites the "net original cost rule" description in support of its position.[30] However, that definition includes the following:

> The net original cost rule was developed in order to protect ratepayers from having to pay higher rates simply because ownership of utility plant has changed, <u>without any actual change in the usefulness of the plant</u>.[31]

Public Counsel points out that "this rule does not exclude cost recovery of any expenditures made by the Company to improve the quality of the system."[32] However, in "almost every," if not "every," Confluence Rivers acquisition the usefulness of the plant to be acquired is in question at the time of acquisition.[33] This is especially true where the existing systems are in a receivership or saddled with Missouri Department of Natural Resources ("MDNR") violations.[34]

The steps necessary for Confluence Rivers to acquire the assets of small, distressed water and sewer utilities ultimately facilitate the provision of utility service and aid in the provision of safe and adequate service as to those systems. Public Counsel quotes Staff witness Majors' statement that "certainly they're current reasonable costs to – that were incurred to acquire systems to eventually make improvements to the system."[35] Staff witness Majors further stated:

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[28] Tr. Volume 9.5, pages 79-80 (Majors).
[29] Tr. Volume 9.5, page 80 (Majors).
[30] Public Counsel Initial Brief, page 24.
[31] *Id*. (emphasis added); *See also*, Exhibit 129, Majors Surrebuttal, page 7.
[32] Public Counsel Initial Brief, page 24.
[33] Tr. Volume 9.5, page 76 (Majors).
[34] *Id*.
[35] Public Counsel Initial Brief, page 27.

> I think as a general premise yes, the transfer of ownership prior to the acquisition -- prior to the acquisition and post acquisition there is an improved, definite improvement in safe and adequate service. No question.[36]

The legal and preliminary engineering costs at issue both "facilitate the provision of utility service" and are "used or useful [or] necessary for the provision of safe and adequate service." Accordingly, they should be recovered by Confluence Rivers in this rate case.

Staff attempts to insert an additional issue by referring to situations where holding companies have been alleged to have attempted to subsidize unregulated activities.[37] It is unclear what this reference has to do with the matter at hand. The costs that are the subject of this issue concern expenditures directly related to assets acquired by a regulated entity (Confluence Rivers) and assets that become regulated as a part of the subject process. These are fundamentally regulated activities of a regulated entity (Confluence Rivers) and do not fit into the danger described by Staff.

The systems acquired by Confluence Rivers were in significant states of disrepair due to significant deferred maintenance, improper operations and depreciated assets that were not properly replaced or even catalogued or mapped. Therefore, some of the preliminary expenditures that Confluence Rivers incurred were intended to determine the extent and scope of the condition of the systems and the needed repairs. The expenditures also included costs to determine proper title and sufficient easement and right of way access to properties or to obtain Commission approval of the transaction. These costs are a necessary component of operations in the present and the future.[38]

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[36] Tr. Volume 9.5, page 79 (Majors).
[37] Staff Initial Brief, pages 11, 14.
[38] Exhibit 18, Thies Rebuttal, pages 11-12.

Given that Confluence Rivers' costs at issue are recorded and capitalized consistent with the USOA, and the resulting capital and operational improvements to these systems cannot occur without incurring such costs, the Commission should reject Staff's proposed disallowance.

B. Amortization

The Staff concludes by indicating that [t]he Commission should deny recovery of the acquisition costs at issues in this case, <u>except to the extent that an item-by-item review establishes that some costs were beneficial to ratepayers</u>.[39] As pointed out in Confluence Rivers' Initial Brief, and above, Staff performed no review of the individual costs to determine whether those legal and preliminary engineering costs at issue "<u>facilitate the provision of utility service</u>" or are "<u>used or useful [or] necessary for the provision of safe and adequate service</u>."

However, Staff also indicates that if costs are to be recovered, recovery should be made "via a five-year amortization, without rate base treatment."[40] Public Counsel similarly indicates that if the costs are to be recovered, they should be amortized over a five-year period.[41]

Amortization, as described by Staff and Public Counsel, is not Confluence Rivers' preferred method of addressing these costs as the costs at issue. Uniform System of Accounts Account 183 – Preliminary Survey and Investigation Charges, states as follows:

> This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc. made for the purpose of determining the feasibility of projects under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged.[42]

Recognizing that Account 183 holds Utility Plant expenditures, the balance in that account is capitalized and included in rate base.[43]

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[39] Staff Initial Brief., page 14 (emphasis added).
[40] Staff Initial Brief, page 14.
[41] Public Counsel Initial Brief, pages 22, 26-27.
[42] *Id*. Exhibit 18, Thies Rebuttal, page 10.
[43] Tr. Volume 9.5, pages 18-19 (Thies).

Having said this, Confluence Rivers does recognize that an amortization of the subject costs over a five (5) year period would be superior to a complete disallowance as the amortization would avoid an immediate write-off and instead effectively result in a write-off over a five-year period, as recovery is received. Therefore, if the Commission believes that capitalizing these costs is not appropriate for some reason, Confluence Rivers would ask that the Commission instead order that the costs be amortized over a five-year period with the addition of the annual amortization amount ($243,793)[44] to the revenue requirement.

[44] $1,218,969/5 years = $243,793.80.

IV. TIMESHEETS

Issue: Should the Commission order Confluence to require its employees, including executives, to keep timesheets that show the activities performed and where they were performed?

Confluence Rivers Initial Brief, pages 29-33
Staff Initial Brief, pages 15-18
Public Counsel Initial Brief, pages 28-35

The initial briefs of both Staff and Public Counsel on this issue focus primarily on the fact that beginning sometime in 2021 certain of Confluence River's executives failed to keep timesheets as required by the *Unanimous Stipulation and Agreement* reached by the parties and approved by the Commission in Case No. WR-2020-0053.[45] But while both briefs accurately recount the Company's past mistakes – for which Mr. Cox apologized – that past conduct is not germane to issues related to timesheets the Commission is called upon to decide in this case. Those issues concern whether Confluence Rivers' executives should be required ***prospectively*** to keep daily timesheets or whether the Company's proposed alternative – Project Time-Tracking – would provide information the Commission requires to determine how these executives' compensation should be apportioned to Missouri ratepayers.

As described in Confluence Rivers' Initial Brief, the number of water and wastewater utilities affiliated with CSWR has grown over the past several years and, as a result, so has the scope of responsibility of its executives. No longer are executives able to devote large amounts of their time to a single state or small group of states. Instead, their focus is on CSWR as a whole. Consequently, if executives are required to keep daily timesheets most of their time would be recorded to the "All Companies" category in the timekeeping system. And all hours recorded to

[45] Staff Initial Brief, pages 15-18; Public Counsel Initial Brief, pages 28-31.

that category must be apportioned to the 11 states where CSWR currently provides service using an allocation factor.

Because most of their worktime must be allocated anyway, the question becomes what is gained from requiring CSWR's executives to fill out daily timesheets? The obvious answer is nothing is gained. The daily timekeeping requirement would thus impose a burden, and an associated cost allocable solely to Missouri, with no corresponding benefit. As Mr. Thies noted in his Rebuttal Testimony:

> The executive and director level of employees of CSWR are involved in setting procedures, monitoring operations performance, supervising employees and contractors and setting strategic direction for the Company. A significant portion of their time is spent discussing these items at a level that impacts all customers of CSWR's subsidiaries and not just those of one individual entity or another. . . This portion of time spent managing at a level which affects all subsidiaries, and all customers, is time and compensation expense that should be allocated based on the Company's three-factor overhead allocation methodology.[46]

Alternatively, as proposed by the Company's witness Brent Thies, CSWR's executive employees – those with a title at director–level and above – would be presumed to apply to all affiliated utilities. However, because all these executives sometimes work on projects that pertain to one or a small subset of affiliated utilities, they would track this time and report it monthly. This would allow such time to be directly assigned to the affiliate(s) for which the work was performed, and would include projects such as audits, state-specific rate cases, and large construction projects. This Project Time-Tracking system would yield the same work-related data as the daily timesheet proposal supported by Staff and Public Counsel but would eliminate the burden of daily timekeeping. Mr. Cox explained the rationale for the Company's proposal as follows:

> [G]iven the tremendous pace of grown which has demonstrably benefited Missouri customers . . . historical time sheets are not reflective of payroll allocations currently or what they should be in the future. As such, I would ask that the need to maintain timesheets should be withdrawn until such time as timekeeping can

[46] Exhibit 18, Thies Rebuttal, page 19.

> provide a useful estimate of ongoing operations. . . Confluence Rivers believes that the requirement to keep daily time sheet is onerous for executives that are responsible for the day-to-day operations of a company that is operating in twelve different states. These executives move dozens of times, throughout the course of the day, for issues arising in each of the CSWR states. It is extremely time-consuming to expect these executives to keep accurate time sheets of the multitude of projects that each address [sic.] on a day-to-day basis.[47]

The Company's Project Time-Tracking proposal is analogous to the timekeeping system the Commission employs to determine how to directly charge or allocate time spent by Commission personnel for purposes of determining annual utility assessments. As noted in the Rebuttal Testimony of Staff witness Ashley Sarver, individual Staff members are required to record time worked on cases or projects "to ensure accuracy in determining the amount of PSC assessment to distribute to the individual utility types as well as by each individual company within a utility type."[48] However, as pointed out by Commission Hahn during the evidentiary hearing, no similar requirement applies to the Commissioners.[49] That's almost certainly attributable to the fact the Commissioners, like CSWR's executives, have much broader responsibilities. Unlike Staff, they do not routinely focus on an individual utility or even a group of utilities (e.g., gas, electric, water, or wastewater) under their jurisdiction. If this dichotomy doesn't prevent the Commission from equitably apportioning its costs among all its jurisdictional utilities, the Company's proposal – which would exempt executives from daily time reporting while requiring all other employees to do so – can equitably apportion CSWR's costs as well.

Because neither Staff nor Public Counsel has put forth a compelling argument for requiring CSWR's executives to keep daily timesheets, the Commission should exempt them from that burden and adopt, instead, the Project Time-Keeping system proposed by Confluence Rivers.

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[47] Exhibit 5C, Cox Surrebuttal, pages 35-36.
[48] Exhibit 131, Sarver Rebuttal, page 14.
[49] Tr. Volume 9.5, page 146.

V. COST OF CAPITAL

Issue: With respect to cost of capital—

a. **What is the appropriate capital structure to use in calculating the Company's rate of return?**
b. **What is the appropriate cost of debt to use in calculating the Company's rate of return?**
c. **What is the appropriate return on common equity to use in calculating the Company's rate of return?**

Confluence Rivers Initial Brief, pages 34-46
Staff Initial Brief, pages 19-40
Public Counsel Initial Brief, pages 36-67

A. Introduction

The United States Supreme Court has indicated that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks." [50]

Staff and Public Counsel continue to view Confluence Rivers no differently than they would Ameren, Spire Missouri, or Evergy and hover around the national "average" return on equity for large utilities. This is in spite of the fact that neither Staff witness Walters, nor Public Counsel witness Murray, are aware of any other utility that is exclusively acquiring small, distressed water and sewer systems like Confluence Rivers.[51] They further seek to apply hypothetical capital structures to further lower the ultimate rate of return and, in the case of Public Counsel, seek to utilize a lower than contract debt rate as applied to hypothetical debt not held by Confluence Rivers.

The Commission should recognize that Confluence Rivers has a relatively small customer base and yet contributes significantly to the public interest through its purchases and improvements made to small, distressed water and sewer systems. This description is vastly different than the average, large utility. Given these factors, an appropriate ratemaking capital structure for

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[50] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (citation omitted) (emphasis added).
[51] Tr. Volume 10, page 115 (Walters), page 137 (Murray).

Confluence Rivers consists of 31.44% long-term debt at a cost rate of 6.60% and 68.56% common equity at a return on common equity of 11.35%.[52]

B. Return on Common Equity

What is the appropriate return on common equity to use in calculating the Company's rate of return?

The appropriate return on common equity for a company the size of Confluence Rivers with the business risk associated with acquiring distressed systems is 11.35%. Confluence Rivers will address various criticisms of the Company's return on equity recommendation from the Staff and Public Counsel briefs in the following paragraphs.

However, at a high level, Staff and Public Counsel continue to generally center their recommendations around the "average" water utility return on equity (ROE) awarded in 2022 and, so far, in 2023, for large water utilities, which is approximately 9.6%.[53] Any adder for the unique characteristics of Confluence Rivers, such as to 100 basis point adder used by Mr. D'Ascendis and the 65 basis point adder used by Public Counsel witness Murray, should certainly take you beyond the "average."

Confluence Rivers will address issues from the briefs related to the business risk adder, zone of reasonableness and the growth rate used by Mr. D'Ascendis. The remaining issues have been addressed in Confluence Rivers' Initial Brief and its testimony.

Business Risk Adder

Staff argues that the 100-basis point adder utilized by Mr. D'Ascendis is unreasonable. This an adjustment based on a size premium study as a proxy for business risk and reflects the Company's increased operating risk as compared to the Utility Proxy Group.[54]

[52] Exhibit 9, D'Ascendis Surrebuttal, page 1.
[53] Tr. Volume 10, pages 135-136 (Murray).
[54] Exhibit 9, D'Ascendis Surrebuttal, page 36.

Staff first argues that the market does not compensate investors for taking risks that can be diversified away.[55] This starting point ignores the United States Supreme Court guidance that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."[56] Thus, the focus is on the company and its risks, not whatever diversification in other investments that might be available to an investor.

Staff further argues that Confluence Rivers' market capitalization is unknown; a small-size adder is not appropriate because it is owned by a parent company with other holdings; and size premiums are not present in utility companies.[57]

As to market capitalization, while Confluence is not publicly traded, Staff witness Walters determined a comparable risk proxy group to determine the return on equity for Confluence. As his proxy group is assumed to be of comparable risk to Confluence Rivers, it is reasonable to assume that Confluence Rivers would have comparable market multiples (such as market-to-book ratios) as the average proxy group company. Because that is the case, multiplying Confluence Rivers' book equity by the average market-to-book ratio of the comparable risk proxy group is a suitable proxy for an estimated market capitalization for Confluence Rivers.[58]

As to the parent company, the return on equity in this proceeding should be set on a stand-alone basis.[59] That is, the witnesses in this case are estimating the return on equity for Confluence Rivers, not its parent. Consistent with the stand-alone ratemaking principle, it is reasonable and appropriate to consider the small size of Confluence Rivers relative to the companies in the Utility Proxy Group.[60]

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[55] Staff Initial Brief, page 36.
[56] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (citation omitted) (emphasis added).
[57] Staff Initial Brief, page 37.
[58] Exhibit 9, D'Ascendis Surrebuttal, page 3.
[59] Exhibit 7, D'Ascendis Direct, pages 6-7.
[60] Exhibit 9, D'Ascendis Surrebuttal, page 4.

Lastly, as to the applicability of the adjustment to utility companies, Confluence Rivers witness D'Ascendis performed two studies that link size and risk for utilities. The first study included the universe of electric, gas, and water companies included in Value Line Standard Edition. For each of the utilities, he calculated the annualized volatility (a measure of risk) and current market capitalization (a measure of size) for each company. After ranking the companies by size (largest to smallest) and risk (least risky to most risky), he made a scatter plot of the data (as shown on page 5 of Exhibit 9). This chart shows that as company size decreases (increasing size rank), the annualized volatility increases, linking size and risk for utilities, which is significant at 95% confidence level.[61]

The second study performed by Mr. D'Ascendis used the same universe of companies, but instead of using annualized volatility, he used the Value Line Safety Ranking, which is another measure of total risk. After ranking the companies by size and Safety Ranking, Mr. D'Ascendis again made a scatterplot of those data (as shown on page 5 of Exhibit 9). Similar to the first study, as company size decreases, Safety Ranking degrades, indicating a link between size and risk for utilities. This study is also significant at the 95% confidence level.[62]

Zone of Reasonableness

Staff argues that a "zone of reasonableness" review indicates that the Company's recommendation is "simple too high."[63]

The Commission has described the "zone of reasonableness" as follows:

> 26. The Commission has described a "zone of reasonableness" extending from 100 basis points above to 100 basis points below the recent national average of awarded ROEs to help the Commission evaluate ROE recommendations. . . .

[61] Exhibit 9, D'Ascendis Surrebuttal, pages 4-5.
[62] Exhibit 9, D'Ascendis Surrebuttal, pages 5-6.
[63] Staff Initial Brief, pages 38-39.

> 27. The Commission has wide latitude in setting an ROE within the zone of reasonableness. <u>The zone of reasonableness is simply a tool to help the Commission to evaluate the recommendations offered by various rate of return experts. It should not be taken as an absolute rule that would preclude consideration of recommendations that fall outside that zone</u>.
>
> 28. In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional requirements.[64]

Thus, while it is a point of reference, the "zone of reasonableness" is not determinative of the return on equity to be found by the Commission or a "rule" that must be followed by the Commission.[65]

Staff suggests a "zone of reasonableness" from 8.4 – 10.4%, based on an assumed national average of 9.4%.[66] As indicated in Confluence Rivers' Initial Brief, it was generally agreed that the "average" water utility return on equity awarded in 2022 and, so far, in 2023, for large water utilities, is approximately 9.6%.[67] This is largely based on an RRA Regulatory Focus report for 2022 and a second such report for 2023.[68]

As stated above by the Commission, "it should not be taken as an absolute rule that would preclude consideration of recommendations that fall outside that zone." The "zone of reasonableness" is set on traditional water companies. Where you are addressing a utility such as Confluence Rivers, which is recognized as riskier than the traditional water company, any adder

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[64] *In the Matter of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities' Tariff Revisions Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Areas of the Company*, Report and Order, 2014 Mo. PSC LEXIS 1054, *44-45, File No. GR-2014-0152 (December 3, 2014) (emphasis added).

[65] Indeed, in response to questions from Chairman Rupp, it was acknowledged that the Commission's past use of the "zone of reasonableness" does not preclude the Commission from setting a return on equity in this case that is "above" that zone of reasonableness. Tr. Volume 10, pages 40-41.

[66] Staff Initial Brief, page 38.

[67] Tr. Volume 10, pages 135-136 (Murray).

[68] Exhibits 236 and 237 (Note that while the 2023 information arrives at a 9.40% average rate award, that calculation includes the 8.70% "outlier" awarded to Aquarion Water Co. of Connecticut (*See* Tr. 132 (Murray)). Without that outlier, the average for 2023 would be 9.58%).

for that riskiness that is deemed appropriate, should be on top of the range. Accordingly, it would not be unreasonable to award a ROE outside the zone of reasonableness.[69]

Moreover, the low end of Mr. D'Ascendis' indicated range of common equity cost rates applicable to the Utility Proxy Group (10.36% and 11.36%), before he adds an adjustment for business risk, fits within that zone of reasonableness. That low end, with the addition of the upward adjustment for business risk (1.00%), as relative to the Utility Proxy Group, brings you back very close to the Company's 11.35% recommendation.

Growth Rate

Staff criticizes the 7.28% DCF growth rate utilized by Mr. D'Ascendis.[70] Confluence Rivers witness D'Ascendis addressed this criticism in his Surrebuttal Testimony as follows:

> Mr. Walters argues that since the average growth rate of the proxy group (7.28%) is higher than the projected growth rate for the economy (4.00%), and no industry can grow at a greater rate than the economy it operates in in perpetuity, a multistage DCF should have been used. As noted in my rebuttal testimony, eight out of fifteen represented industries, including utilities, grew faster than the overall GDP from 1947 to 2022. Moreover, as suggested by financial literature the public utility industry is in its steady-state, or constant-growth stage of a multi-stage DCF.[71]

Mr. D'Ascendis growth rate is supported by historical observations and financial literature. The criticisms are unfounded.

Conclusion

The size and nature of Confluence Rivers' business justifies a ROE well above the average large water utility return on equity. The Commission should utilize an ROE of 11.35%, for the reasons stated herein and in Confluence Rivers' Initial Brief.

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[69] Tr. Volume 10, pages 39-41 (D'Ascendis).
[70] Staff Initial Brief, pages 35-36.
[71] Exhibit 9, D'Ascendis Surrebuttal, pages 7-8.

C. Capital Structure

What is the appropriate capital structure to use in calculating the Company's rate of return?

The appropriate capital structure is Confluence Rivers' actual capital structure of 68.56% common equity and 31.44% long term debt,[72] which includes the actual debt issuance with CoBank authorized by the Commission in December 2022.

Staff acknowledges that "[t]raditionally, the Commission has used the company's actual book value capital structure as of the end of the test year for ratemaking."[73] However, Staff argues that the ratio identified by the Company is not Confluence Rivers' "actual" capital structure and suggests that a much lower equity ratio is shown by the Company's 2022 financial statement.[74] The difference is how one treats the affiliate payables. Confluence Rivers' stated capital structure follows CoBank's method of estimation. That is, it treats affiliate payables as equity.[75] It is this approach that has been used by Confluence Rivers – an approach with which even Public Counsel Murray agrees.[76]

Staff argues that Confluence Rivers' equity ratio should not be used because it exceeds the average equity ratio for Staff witness Walters' proxy group and proposes that a hypothetical capital structure should be used.[77] However, Confluence Rivers witness D'Ascendis pointed out that the common equity ratios for water-only utilities identified by Staff witness Walters range from 47.50% to 62.10%.[78]

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[72] Exhibit 7, D'Ascendis Direct, page 15.
[73] Staff Initial Brief, page 24.
[74] Staff Initial Brief, page 24.
[7575] Exhibit 209, Murray Direct, page 6.
[76] *Id*.
[77] Staff Initial Brief, pages 24-25.
[78] Exhibit 8, D'Ascendis Rebuttal, page 9; *See also*, Exhibit 109, Walters Direct, Exhibit CCW-2.

Staff suggests that its use of a hypothetical capital structure is justified by the *State ex rel. Associated Nat. Gas Co. v. Pub. Serv. Comm'n of Missouri*[79] case. Specifically, Staff points to "the situation where 'the utility's actual debt-ratio is deemed inefficient and unreasonable because it contains too much equity and not enough debt, necessitating an inflated rate of return.'"[80]

Staff's position assumes that it is possible for a utility to have a lower equity ratio. Currently, and under the conditions present during the test year and update period in this case, a lower equity ratio is not available to Confluence Rivers. Confluence Rivers witness Thies discussed the debt covenant requiring that at the end of the year Confluence Rivers will not have total debt that exceeds six (6) times its EBITDA (defined as "operating revenues minus operating expenses, plus depreciation and amortization expenses and non-cash expenses for Holding Company management fees").[81] Regardless of the total debt percentage, that requirement indicates a pre-rate case total debt capacity limit of $5,840,028,[82] an amount even less than Confluence Rivers' current indebtedness.

Given the common equity rations maintained by water utilities, and the Company's actual common equity ratio, a ratio at the top of the range is reasonable and correctly adjusts for difference in financial risk.[83] Mr. D'Ascendis further made a downward adjustment to account for the Company's lesser degree of financial risk relative to the Utility Proxy Group in the amount of 0.51%.[84] This is the appropriate way to address any concern related to the equity ratio. On the other hand, a hypothetical equity ratio of 50.00%, as suggested by Staff, incorrectly adjusts

[79] Staff Initial Brief, pages 25-26; *State ex rel. Associated Nat. Gas Co. v. Pub. Serv. Comm'n of Missouri*, 706 S.W.2d 870 (Mo.App. 1985).
[80] *Id*.
[81] Exhibit 209, Murray Direct, Sched. DM-D-3 C, page 11.
[82] Exhibit 18, Thies Rebuttal, page 31.
[83] Exhibit 8, D'Ascendis Rebuttal, pages 9-10.
[84] *Id*.

Confluence Rivers' common equity ratio beyond a level reflective of its operations and those of similarly operated water utilities.[85]

Public Counsel argues that the Commission should use a hypothetical capital structure consisting of 45% common equity and 55% long-term debt because that is the minimum equity that Confluence Rivers could have under its existing debt covenants with CoBank.[86] This argument is a "red herring."[87]

The 45% equity capital structure included in the referenced CoBank debt covenant is not a target, it is a *do not exceed* parameter. It prohibits Confluence Rivers from over leveraging its assets through other lenders to the detriment of CoBank. It also does not represent an offer on the part of CoBank to provide additional debt funding. It represents an outside parameter of the most debt Confluence Rivers could carry without violating its debt covenants. That, almost by definition, is not a reasonable capital structure. No other utility capital structure is set by assessing the greatest amount of debt it could borrow without violating an existing debt covenant. There is no reason to do so with Confluence Rivers.

Public Counsel further assesses financial performance of the "legacy operating subsidiaries" - Hillcrest Utility Operating Company, Inc. ("Hillcrest"); Elm Hills Utility Operating Company, Inc. ("Elm Hills"); Osage Utility Operating Company, Inc. ("Osage"); Raccoon Creek Utility Operating Company, Inc. ("Raccoon Creek); and Indian Hills Utility Operating Company, Inc. (Indian Hills) - and alleges that they could support certain percentages of debt in their capital structures "if they continued as stand-alone companies."[88]

[85] *Id*.
[86] Public Counsel Initial Brief, page 37; Exhibit 209, Murray Direct, page 4.
[87] A clue or piece of information that is, or is intended to be, misleading or distracting.
[88] Public Counsel Initial Brief, page 38.

This point has no import. Those legacy subsidiaries did not continue as stand-alone companies and no longer exist. They were merged into Confluence Rivers as of January 1, 2022, pursuant to authority granted by the Commission in File No. WM-2021-0412. Confluence Rivers cannot treat these systems separately, even if they wanted to.

Even if the named entities did exist, they would not have the same assets or finances as additional assets have been acquired. Moreover, they cannot be treated as separate entities going forward. As Public Counsel witness Murray agreed, the only way that the Company can ultimately get a rate adjustment that those new systems is to bring the entire Company in for a rate case.[89]

Public Counsel further argues a distraction by suggesting that utilizing its actual capital structure would somehow "subsidize acquisitions of new systems."[90] It further suggests that the legacy systems have subsidized capital needs of newly acquired Missouri systems.[91]

First, revenues received by Confluence Rivers are theirs to use as they please and are fungible. A utility should not be disadvantaged because it decides to reinvest its funds into infrastructure improvements rather than paying dividends. Most important, the combined company must provide a return reflecting the risks of the company's constituent parts. This is consistent with the regulatory principle of treating utilities as stand-alone entities.[92] It is the utility's operating risk that defines the capital structure and cost of capital, and certainly not the use of funds.

The Commission should use the actual capital structure of Confluence Rivers as the capital structures recommended by Public Counsel and Staff are not only hypothetical, but they are also

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[89] Tr. Volume 10, page 144 (Murray).
[90] Public Counsel Initial Brief, page 38.
[91] *Id*. at page 39.
[92] Exhibit 9, D'Ascendis Surrebuttal, page 16.

unrealistic and ignore the circumstances with which Confluence Rivers must contend when purchasing small, distressed utilities.

D. <u>Cost of Debt</u>

What is the appropriate cost of debt to use in calculating the Company's rate of return?

Confluence Rivers and the Staff both take the position that the embedded cost of debt, and therefore the cost of debt to use for purposes of calculating the rate of return, is 6.60%, which reflects the debt cost of the CoBank debt issuance approved by the Commission in December 2022.[93]

Public Counsel takes the position that the debt rate should be reduced to reflect what he views to be anticipated "patronage credits."[94] As a result of this reduction, Public Counsel supports a debt cost of 6.23%.[95]

Confluence Rivers pointed out that patronage credits are not referenced in Confluence Rivers' loan agreement and are not guaranteed to be paid.[96] Moreover, Confluence Rivers has no significant experience with the patronage credits, given that its loan has been in place for less than a year.

Staff notes that "the use of Mr. Murray's cost of debt with Staff's capital structure and ROE would result in a lower [rate of return]. . . ."[97] This is certainly true and deserves some additional exploration. If the Commission uses one of the proposed hypothetical capital structures in this case, it is necessarily assuming a greater amount of debt than the existing CoBank debt issuance. Under Staff's recommendation it also assumes for purposes of the rate of return that Confluence

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93 Staff Initial Brief, page 26.
94 Public Counsel Initial Brief, page 45.
95 *Id*.
96 Exhibit 8, D'Ascendis Rebuttal, pages 48-49.
97 Staff Initial Brief, page 27.

Rivers could achieve that greater level of debt at the 6.60% reflected in its existing debt. Public Counsel takes this one step further and wants to assume patronage credits for that phantom amount of debt – patronage credits that Confluence Rivers will never receive under any circumstance, because it does not have that amount of debt.

It was suggested by Public Counsel witness Murray in his Surrebuttal Testimony, although not ascribed to him in Public Counsel's Brief, that an alternative to reducing the debt costs for purposes of the rate of return, would be to capture any patronage credits received by the Company on a going-forward basis, with carrying costs based on the 6.60% interest rate.[98] Given its inexperience with this issue, the Company took the position that deferral of any such amounts received to a regulatory liability account would be an acceptable treatment of this issue and eliminate any reason to reduce the contractual debt cost for the purpose of calculating the appropriate rate of return.

In the case of a hypothetical capital structure, this approach has the additional benefit that it recognizes any and all patronage credits actually received by Confluence Rivers and does not penalize the Company for patronage credits it will never receive, under any circumstance. Ultimately, this is a fair and reasonable way to address the issue raised by Public Counsel. It will provide the opportunity for customers to receive the benefit of no less and no more of any patronage credits received.

Confluence Rivers' appropriate cost of debt is 6.60%, which reflects the debt cost from the CoBank debt issuance approved by the Commission in December 2022.

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[98] Exhibit 211, Murray Surrebuttal, p. 13.

VI. ADVANCED METER INFRASTRUCTURE INVESTMENTS

Issue: Should the Commission disallow any costs related to AMI meter investments?

Confluence Rivers Initial Brief, pages 47-49
Staff Initial Brief, page 40[99]
Public Counsel Initial Brief, pages 68-70

In its Initial Brief, Public Counsel continues to propose that the Commission disallow $26,768 of rate base investment associated with AMI meters installed at Hillcrest and Indian Hills. In making its disallowance, however, Public Counsel conflates investment in hardware (AMI meters) with investment in software (Orion AMI attachments). Specifically, Public Counsel's argument focuses entirely on the usefulness of software.

> The Orion AMI attachments are not a prudent investment. Spending more money to enhance an already imprudent investment would be doubling down on the mistake and needlessly increasing rate base. I would be hard pressed to find a present scenario where investing in water AMI attachments and accompanying customer service software would be a prudent investment.[100]

That all said, Public Counsel fails to point out that while Confluence Rivers has invested in AMI meters, it has not invested in the Orion AMI attachments. Therefore, since Confluence Rivers has not invested in the Orion AMI attachments (software), Public Counsel has provided no justification for the disallowance of the AMI meter (hardware) investment.

Public Counsel's inability to justify its disallowance of AMI meter (hardware) investment is not surprising. As detailed in Confluence Rivers' Initial Brief, the AMI meters allow for "(1) quicker identification of high-use events and leak detection and (2) a decrease in operational expense by eliminating manual meter reading."[101] In fact, Confluence Rivers indicated that a significant portion of the 5.53% reduction in annual O&M costs (approximately $93,701) is

[99] Staff took no position on this issue.
[100] Public Counsel Initial Brief, page 69 (citing to Exhibit 206, Marke Direct, page 12).
[101] Confluence Rivers Initial Brief, page 47 (citing to Exhibit 206, Marke Direct, page 9).

associated with the "decrease in operational expense by eliminating manual meter reading" associated with the installation of the AMI meter hardware.[102] Given that the investment in AMI meters drives reductions in O&M expense that will, in the short term, pay off the cost of the AMI meters, the investment is such meters was prudent and the Public Counsel disallowance should be rejected.

[102] *Id.* at pages 47-48.

VII. OPERATIONS, MAINTENANCE, AND OVERSIGHT

Issue: With respect to operations, maintenance, and oversight—

c. Should the Commission order a disallowance related to Confluence's contract-based business model, and if so, how much?

Confluence Rivers Initial Brief, pages 50-65
Staff Initial Brief, page 40
Public Counsel Initial Brief, pages 71-172

Public Counsel's quest to identify and dictate how Confluence Rivers should satisfy the need for operations and maintenance ("O&M") services at its more than 70 water and wastewater systems is reminiscent of Captain Queeg's obsessive search, in *The Caine Mutiny*, for a measure of prized strawberries he's convinced one of his shipmates stole from the officers' mess. But there's at least one glaring difference: Captain Queeg almost certainly knew something about strawberries, while, as both its testimony and initial brief clearly show, Public Counsel knows little or nothing about what's required to operate and maintain the Company's systems. That's probably why Public Counsel's proposed "solution" is a moving target.

In its pre-filed testimony, Public Counsel claimed that if Confluence Rivers divided its service area into nine "divisions" and hired a single, solely responsible employee for each division the Company could satisfy all its O&M needs for an annual expenditure of just \$600,000.[103] However, Public Counsel's initial brief paints a much different picture. Under its revised proposal, the number of employees required to perform routine O&M functions balloons from 9 to 15 and the estimated annual cost more than doubles – to an annual cost of \$1,212,303.[104] The due process and evidentiary problems associated with this attempt to present a new, radically different proposal

[103] Exhibit 207C, Marke Rebuttal, pages 9-12.
[104] Public Counsel Initial Brief, pages 169-170.

for first time in a post-hearing brief are obvious, overwhelming, and ultimately disqualifying.[105] But even beyond those significant legal defects, would it be reasonable – or rational – for the Commission to rely on analyses and recommendations that changed so drastically over the roughly three-week period between the conclusion of evidentiary hearings in this case to the date Public Counsel filed its initial brief?

The majority of the more than 100 pages Public Counsel's Initial Brief devotes to this issue are spent trying to prove how many MDNR-certified operators third-party contractors currently use to service Confluence Rivers' systems, which systems those operators service, and how many similarly certified operators it would take to perform the same functions if responsibility for all O&M functions is moved in-house for the future. It would be futile to point out the numerous flaws in Public Counsel's analysis, which include the unfounded assumption that most functions third-party contractors currently perform require an MDNR-certified operator. As Mr. Cox explained, and as even a cursory review of the list of duties the Company imposes in its third-party contractors confirms,[106] many diverse skillsets are required to provide required O&M services.

> [A]n operator's work goes well beyond simple inspection. In addition, when systems fail these operators are also tasked with performing repairs as systems fail. For example, when pumps, blowers and aerators need replacing, the operators are generally expected to perform such replacements. . . Given the distressed nature of the systems acquired by Confluence Rivers, these repair responsibilities are significant and time consuming.[107]

But the primary flaw in Public Counsel's analysis, and ultimately in its proposal, is more fundamental. There is no evidence anyone involved in Public Counsel's analysis of Confluence

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[105] *See Tonkin v. Jackson County Merit System Comm'n*, 599 S.W.2d 25, 32-33 (Mo.App. 1980) (Due process requires administrative proceedings afford parties rudimentary elements of fair play, including the right to know opponents' claims, to hear evidence, and to confront witnesses and rebut their testimony.) *See also, Goldberg v. Kelly,* 397 U.S. 254, 269 (1970) ("In almost every setting where important questions turn on questions of fact, due process requires an opportunity to confront and cross examine adverse witnesses.").
[106] Exhibit 233.
[107] Exhibit 6 Cox Surrebuttal, pages 38-39.

Rivers' O&M operations or the development of the proposed alternative to the continued use of third-party contractors has any training or work experience in the design, operation, or maintenance of water or wastewater systems. Indeed, there is no evidence Dr. Marke or anyone else responsible for Public Counsel's proposal(s) has even visited the facilities to which that alternative proposal would apply. Consequently, it would be unreasonable to adopt or rely on recommendations made by people with no relevant experience or expertise.

In contrast, Messrs. Cox and Thomas, who developed and oversee CSWR's use of third-party contractors to perform O&M functions for all affiliated utility operating companies, have extensive training and experience. They also are required to regularly deal with issues related to the design, operation, and maintenance of water and wastewater systems as part of their day-to-day job responsibilities. Their decision to continue to use contractors to meet Confluence Rivers' O&M needs and the rationale underlying that decision should not be disregarded absent compelling evidence that decision is unreasonable.

Although Staff took no specific position on Public Counsel's proposal(s), it acknowledged that "cutting funding for current contracts is not in the best interest of customers."[108] However, if the Commission believes Confluence Rivers' use of third-party contractors to provide O&M services warrants additional study, a portion of the *Non-Unanimous Partial Stipulation and Agreement* between Staff and the Company provides that opportunity. Under that proposal, within nine months of the Commission's Report and Order in this case Confluence Rivers would present to both Staff and Public Counsel a formal study that includes a cost/benefit comparison of the use of third-party contractors versus in-house personnel to perform required O&M tasks. The formal study would include, but not be limited to, the location of Confluence Rivers' systems (including

[108] Staff Initial Brief, page 40.

the distance between those systems), the age and condition of the systems, the types of technology employed at each system, the O&M services required by each system, the number of operators required to perform those services, and the compensation such operators likely would require. All parties would then meet within ninety days of the report to discuss the Company's findings and conclusions. Confluence Rivers would update its study prior to its next general rate case so that any party wishing to challenge the Company's findings could do so in that case.

This option is vastly superior to Public Counsel's proposal. Therefore, if further study of this issue is the objective, the Commission should adopt the stipulation that includes that process.

VIII. CONCLUSION

For all the reasons expressed in this brief and its Initial Brief, and based upon the competent and substantial evidence in the record, Confluence Rivers recommends that the Commission adopt the following positions:

1. Income Taxes: Consistent with all other Missouri rate cases, as well as the Staff's past position in Confluence Rivers' rate cases, Confluence Rivers recommends that the Commission include a normalized level of income taxes in the revenue requirement in this case.

2. Acquisition-Related Costs: The systems acquired by Confluence Rivers were in significant states of disrepair due to significant deferred maintenance, improper operations and depreciated assets that were not properly replaced. Absent the incurrence of the acquisition-related costs, the acquisition would never occur. These costs are a necessary component of operations in the present and the future.[109] The Commission should deny Staff's proposed disallowance of these costs and allow them to remain in Confluence Rivers' rate base.

3. Timesheets: Because Staff has failed to demonstrate its proposal to require CSWR's executives to maintain daily timesheets would provide any benefits – because time charged to "All Companies" under such an arrangement would still need to be apportioned using an allocation factor – and because adoption of a consolidated rate structure would obviate any need to record time at a system or tariff district level, the Commission should reject Staff's timekeeping proposal. Instead, the Commission should free executives (director and above) from the obligation to maintain timesheets. In the alternative, Confluence Rivers asks that it be allowed to implement the Project Time Tracking system proposed by Mr. Thies. Under either scenario, employees below the director level would continue to keep timesheets.

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[109] Exhibit 18, Theis Rebuttal, pages 11-12.

4. Cost of Capital: An appropriate ratemaking capital structure for Confluence Rivers given its size and the nature of its operations consists of 31.44% long-term debt at a cost rate of 6.60% and 68.56% common equity at a return on common equity of 11.35%.[110]

5. Advanced Meter Infrastructure Investments: The AMI investment at Hillcrest and Indian Hills helped to drive approximately $93,701 of annual O&M savings in the form of meter reading savings. This annual savings greatly exceeds the annual return of an on investment ($26,76) for the Hillcrest and Indian Hills AMI meters. As such, Public Counsel's proposed disallowance of the cost of AMI meters at Hillcrest and Indian Hills is misplaced.

6. Operations, Maintenance, and Oversight: The Commission should adopt the position of Confluence Rivers and Staff as set forth in their non-unanimous stipulation. That proposal would require the Company to perform a formal cost/benefit study of moving responsibility for O&M in-house as opposed to continuing to use third-party contractors. The results of the study would then be shared with Staff and Public Counsel for their review and critique. The study also would be updated prior to Confluence Rivers' next general rate case.

[110] Exhibit 9, D'Ascendis Surrebuttal, page 1.

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ATTORNEYS FOR CONFLUENCE RIVERS UTILITY OPERATING COMPANY, INC.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, to all parties by their attorneys of record as provided by the Secretary of the Commission.

Dean L. Cooper

Dated: September 19, 2023