STATE TAX COMMISSION OF MISSOURI

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| UNION ELECTRIC COMPANY, d/b/a | ) |  |
| Ameren Missouri, | ) |  |
| Complainant, | ) |  |
|  | ) |  |
| v. | ) | Appeal Number: 13-52002 |
|  | ) |  |
| CHRISTOPHER ESTES, ASSESSOR, | ) |  |
| COLE COUNTY, MISSOURI, | ) |  |
| Respondent. | ) |  |

**ORDER AFFIRMING HEARING OFFICER DECISION**

**UPON APPLICATION FOR REVIEW**

# HOLDING

This matter is before the State Tax Commission (Commission) on remand from the circuit court of Cole County. Respondent filed an application for review of the Hearing Officer’s decision and order finding $28,031,000 in depreciation of Complainant's business personal property.[[1]](#footnote-1) The Hearing Officer’s decision and order is AFFIRMED.[[2]](#footnote-2)

# FINDINGS OF FACT AND PROCEDURAL HISTORY

Complainant owns a natural gas pipeline. The subject property consists of components of Complainant's pipeline located in Cole County as of January 1, 2013.

Complainant listed the subject property on a form promulgated by the Commission pursuant to section 138.320. The form required Complainant to "file the original or historical costs[.]" The form further provided the Commission "recommended depreciation assignment follow the IRS guidelines found within IRS Publication 946" and that the "determination of value is the responsibility of the county assessor." Consistent with the form, the Commission's Assessor's Manual advised companies should "rely on original costs as a starting point. It is important for the assessor to arrive at a reasonable level of depreciation."

Complainant reported the original costs were $53,252,364. After deducting depreciation, Complainant reported a total value of $20,498,505.Respondent valued Complainant's property at $53,252,400.

Complainant appealed Respondent's valuation to the Cole County Board of Equalization. The Board sustained Respondent's value. Complainant appealed. The Commission affirmed the Board's decision. The circuit court affirmed the Commission's decision. The court of appeals reversed the circuit court's judgment and directed the circuit court to remand the matter to the Commission to calculate the depreciation of the subject property. *Union Elec. Co. v. Estes*, 534 S.W.3d 352, 376 (Mo. App. 2017). The court of appeals' directions on remand were clear and unequivocal:

This matter is remanded to the Circuit Court of Cole County for remand to the Commission to calculate the true value in money of Ameren's real property in service in Cole County as of January 1, 2013 by determining the amount of depreciation to be deducted from $53,252,400, the "Market Value" determined by the Assessor without regard to depreciation.

*Id.* at 379.

Consistent with the directions on remand, the Hearing Officer conducted a hearing and determined Complainant produced substantial and persuasive evidence showing $28,031,000 in depreciation. The Hearing Officer credited Complainant's expert appraiser, Robert Reilly, who produced a depreciation report calculating $19,624,000 for physical depreciation and $8,407,000 for economic obsolescence, for a total of $28,031,000 in depreciation. Consistent with the Court’s directions on remand, the Hearing Officer reviewed the evidence of the parties and determined the amount of depreciation ($28,031,000) to be deducted from the original market value ($53,252,400), which meant that as of January 1, 2013, the true value in money (TVM) of the subject property was $25,221,400.

Respondent filed an application for review asserting: (1) the Hearing Officer failed to make sufficient findings of fact regarding economic obsolescence; and (2) there was no substantial and competent evidence of economic obsolescence. Respondent's application for review does not challenge Reilly's determination there was $19,624,000 of physical depreciation. Despite not challenging Complainant's evidence showing $19,624,000 of physical depreciation, Respondent asks the Commission to find the subject property depreciated by only $6,390,288, yielding a TVM of $46,862,112.

Complainant is a rate based regulated utility. The Missouri Public Service Commission sets Complainant's allowable rates of return.

The subject property consists of components of Complainant's natural gas pipeline located in Cole County as of January 1, 2013. Complainant listed the subject property on a form promulgated by Commission pursuant to section 138.320. The form required Complainant to "file the original or historical costs[.]" Respondent valued Complainant's property at $53,252,400. The market value of the subject property prior to deducting depreciation is $53,252,400.

Respondent's expert appraiser, George Sansoucy, calculated $6,390,228 of depreciation. Sansoucy testified the court of appeals incorrectly required the deduction of depreciation from original costs because market derived depreciation cannot be deducted from historic original costs. Sansoucy testified the court's approach is inconsistent with generally accepted appraisal principles and amounted to a "jurisdictional exception . . . for developing the cost approach in the appraisal of gas distribution property."

Contrary to the court of appeals' directions on remand, Sansoucy testified the proper approach required subtracting depreciation from the reproduction cost or replacement cost new of an asset, not the original cost. Sansoucy testified depreciation may be deducted from original cost of $53,252,400 only if replacement cost new less depreciation (RCNLD) is less than the original cost.

Although Sansoucy testified market derived depreciation cannot be deducted from historic original costs, he proceeded to do just that. Sansoucy calculated depreciation by comparing the sale prices of natural gas distribution properties from which depreciation could be extracted. Sansoucy noted a correlation between sales prices and surviving original cost and testified "[s]ales of state regulated retail gas distribution property tends to fall in a range of 85% and 115% of the surviving original cost." Sansoucy selected six comparable sales and determined "[T]he mean and median sales price to original costs are 89% and 88%, respectively." Based on his conclusion the median depreciation was 12%, Sansoucy determined $6,390,288 in depreciation should be deducted from the $53,252,400 original cost, yielding a market value of $46,862,112.

Complainant's expert, Robert Reilly, is a certified public accountant and real estate appraiser. Reilly testified credibly and produced a credible depreciation report utilizing a "cost approach, historical cost less depreciation method of valuation of the . . . natural gas distribution system." For rate based regulated utilities like Complainant, historical cost is frequently used to value property for ad valorem tax purposes. Reilly testified historical cost less depreciation (HCLD) is a frequently used valuation method because a regulated utility's rates are set to recover historical costs.

Depreciation consists of physical deterioration, functional obsolescence, and economic obsolescence. Reilly determined physical deterioration by considering a 2008 depreciation study prepared by Gannet & Fleming, which the Missouri Public Service Commission (PSC) utilized to establish the physical depreciation rates applicable to Complainant. Reilly also relied on the accumulated depreciation reported to the PSC and Federal Energy Regulatory Commission as an estimate of the physical depreciation. The physical depreciation reported is based on property data compiled by a third party specialist familiar with the subject property. Reilly calculated $19,624,000 in physical depreciation. Respondent's application for review does not challenge Reilly's physical deterioration analysis or calculation.

The evidence showed that the subject property performs its intended function and is not functionally obsolescent. However, economic obsolescence occurs when the property owner can no longer earn a fair return on investment in the property. Reilly credibly testified four factors established the subject property was subject to economic obsolescence: (1) the allowed rate of return was decreasing; (2) investor owned utilities were failing to earn their allowed rates of return; (3) increased competition, weather conditions, and higher energy efficiency standards were negatively affecting Complainant’s return; and (4) a negative industry outlook.

Reilly's analysis showed an industry wide downward trend in the allowed rate of return prior to January 1, 2013. In 2008, the rate of return was 10.42%. By 2012, the rate of return decreased to 9.94%. The decreasing rate of return supports a finding of economic obsolescence. Reilly's analysis credibly demonstrated investor owned utilities were generally failing to earn their allowed rates of return. Reilly's analysis credibly demonstrated the overall industry outlook was negative. For instance, Standard & Poor's noted a negative outlook for the natural gas industry due to the utilization of alternative energy sources to satisfy increased demand. Consistent with this industry wide trend, Complainant's gas distribution system was incurring additional costs while consumer demand declined.

Reilly reported Complainant’s operating income from 2008 through January 1, 2013. Complainant's operating income decreased at an annualized rate of 8.8% due to weather conditions, efficiency standards, and competition from alternative energy sources.

Reilly quantified economic obsolescence with three applications of the capitalization of income loss depreciation method.

In the first application, Reilly compared five industry wide profitability ratios for each of the five years prior to 2013. Reilly chose the year with the highest profitability as the year with no economic obsolescence, and the lowest profitability year as the year with economic obsolescence. Reilly measured the difference between the highest and lowest profitability ratios. This procedure, found in the *Appraisal Handbook* of the Western State Association of Tax Administrators, indicated economic obsolescence was 32%.

In the second application, Reilly compared Complainant's 2012 profitability ratio (the least profitable year) to Complainant's profitability ratios over the last five years. The median indicated economic obsolescence based on this application was 13%.

In the third application, Reilly compared Complainant's net operating income return on its natural gas utility plant to a guideline natural gas distribution company return based on five companies reporting to Missouri Public Service Commission from 2008 through 2012. This method indicated economic obsolescence ranging from 37% to 47%. Reilly concluded this approach indicated 42% economic obsolescence.

Reilly calculated economic obsolescence ranging from 13% to 42%. The average economic obsolescence was 29%, and the median was 32%. The average and median of the two economic obsolescence percentage indications specific to Complainant was 27.5%. Reilly reconciled the results and concluded economic obsolescence was 25%, yielding a total depreciation of $28,031,000.

The total depreciation of the subject property was $28,031,000. Subtracting $28,031,000 from the original cost of $53,252,400 as required by the court of appeals' remand yields a TVM of $25,221,400.

**CONCLUSIONS OF LAW**

**Respondents’ Application for Review**

Respondent asserts the following in his application for review:

(1) the Hearing Officer failed to make sufficient findings of fact regarding economic obsolescence; and

(2) there was no substantial and competent evidence of economic obsolescence.

Respondent's application for review does not challenge Reilly's determination there was $19,624,000 of physical depreciation. Despite not challenging Complainant's evidence showing $19,624,000 of physical depreciation, Respondent asks the Commission to find the subject property depreciated by only $6,390,288, yielding a TVM of $46,862,112.

### Standard of Review

A party subject to a Decision and Order of a Hearing Officer with the STC may file an application requesting the case be reviewed by the STC. Section 138.432. The STC may then summarily allow or deny the request. *Id*. The STC may affirm, modify, reverse, set aside, deny, or remand the Decision and Order of the Hearing Officer on the basis of the evidence previously submitted or based on additional evidence taken before the STC. *Id*.

The Commission reviews the Hearing Officer's decision and order de novo. *Lebanon Properties I v. North*, 66 S.W.3d 765, 770 (Mo. App. 2002). "The extent of that review extends to credibility as well as questions of fact." *Id.* The Commission "is free to consider all pertinent facts and estimates and give them such weight as reasonably they may be deemed entitled to." *St. Louis Cty. v. State Tax Comm'n*, 515 S.W.2d 446, 450 (Mo. 1974).

### STC’s Ruling

For the reasons that follow, the STC finds Complainants’ arguments to be unpersuasive. The STC, having thoroughly reviewed the whole record and having considered the Hearing Officer’s Decision, the Application for Review of Respondents, and Complainant’s Response, concludes that the Hearing Officer’s Decision was correct and proper and not erroneous.

**I. The Hearing Officer's factual findings were sufficient.**

Respondent claims the Hearing Officer failed to make sufficient findings of fact as required by section 536.090. Section 536.090 requires findings of fact and conclusions of law to permit meaningful judicial review of whether the agency decision falls within the scope of the invalid agency actions enumerated in section 536.140.2. *Weber v. Firemen's Retirement Sys.,* 872 S.W.2d 477, 480 (Mo. banc 1994). The Hearing Officer’s findings of fact, incorporated herein, are sufficient in that they provide an explanation and basis for the Hearing Officer’s decision. *Rednam v. State Bd. Of Registration for Healing Arts*, 316 S.W.3d 357, 361-62 (Mo. App. W.D. 2010); *State ex rel. Laclede Gas Co. v. Public Service Com’n of the State of Missouri*, 103 S.W.3d 813, 816 (Mo. App. W.D. 2003); s*ee also* *Rinehart v. Bateman,* 363 S.W.3d 357, 363 (Mo. App. 2012).[[3]](#footnote-3) “An inflexible standard for determining the adequacy of findings of fact has not been espoused in Missouri.” *State ex rel. Laclede Gas Co.*, 103 S.W.3d at 816, *citing Glasnapp v. State Banking Bd.*, 545 S.W.2d 382, 387 (Mo. App. 1976). The Hearing Officer’s findings of fact do not leave the Commission to speculate as to the evidence the Hearing Officer believed and found to be true and which evidence was rejected. *See Id*. At 816. Respondent's claim that the Commission should reverse the Hearing Officer's decision due to allegedly insufficient factual findings is without merit.

**II. The Hearing Officer's decision and order is supported by substantial and persuasive evidence.**

Respondent claims there was no substantial and competent evidence of economic obsolescence.[[4]](#footnote-4) The record refutes this claim.

At the outset, it is critical to emphasize the court of appeals' directions on remand.

The court noted the Commission's 2013 form requiring assessors to use the reproduction cost approach to value natural gas pipeline property was consistent with section 137.122 because the statute "***requires*** use of the reproduction cost approach." *Estes*, 534 S.W.3d at 367. Specifically, section 137.122.5 provides "***each assessor shall value*** depreciable tangible personal property by applying the class life and recovery period to the ***original cost*** of the property according to the following depreciation schedule." In other words, the starting point for valuing the subject property is, per the Commission's 2013 form and section 137.122, the original cost of the subject property.

Once the original cost is determined, depreciation is deducted according to the section 137.122 depreciation schedule, which based on the federal Modified Accelerated Cost Recovery System (MACRS) life table. The depreciation schedule determines the appropriate "class life" of depreciable tangible personal property used in a trade or business or for production of income. Although section 137.122 does not address the valuation of real property, the Commission’s decision to utilize a form requiring assessors to use the same valuation methodology for both real property and tangible personal property owned by natural gas distribution companies was "logically grounded." *Estes*. at 369. Given this context, the court's directions on remand in this case clearly and unequivocally dictate:

This matter is remanded to the Circuit Court of Cole County for remand to the Commission to calculate the true value in money of Ameren's real property in service in Cole County as of January 1, 2013 by determining the amount of depreciation to be deducted from $53,252,400, the "Market Value" determined by the Assessor without regard to depreciation.

*Estes*, 534 S.W.3d at 379. The sole issue, therefore, is determining the amount of depreciation to be taken against $53,242,400, as directed by the Court.

Despite the court's clear direction to calculate depreciation against the original cost of $53,242,400, Respondent's appraiser, Sansoucy, prefaced his testimony by disputing the court's directions on remand. Sansoucy testified the court "requires that depreciation be deducted from the historic original cost of the real property" even though market based depreciation cannot be deducted from original costs. Sansoucy testified deducting depreciation from original cost of real property is not a generally accepted appraisal method, and "the Missouri Court of Appeals created a Jurisdictional Exception…for developing the cost approach in the appraisal of gas distribution property."

Contrary to the court of appeals' directions on remand, Sansoucy testified the proper approach required subtracting depreciation from the reproduction cost or replacement cost new of an asset, not the original cost. The court of appeals, however, expressly rejected Sansoucy's "cost new" valuation methodology and reaffirmed original cost is the starting point:

We recognize that "cost new," the essence of Mr. Sansoucy's valuation methodology, is essentially "replacement cost" in today's dollars employing today's standards, a recognized cost approach methodology. However, to the extent the subject has been addressed, Missouri courts have observed that the reproduction/original cost methodology is generally most applicable to specialized uses of property. *See* *Snider*, 156 S.W.3d at 347 (noting that assessor used reproduction cost approach to value ***specialized use of property*** “by taking the actual cost of acquiring and improving the property and decreasing that amount to account for ... depreciation and depletion”) (emphasis added). It is noteworthy that the Commission's Decision and Order found a natural gas pipeline system to be a "unique" use of property.

*Estes*, 534 S.W.3d at 375 n.24. (Emphasis in original). The court further observed "that Mr. Sansoucy's valuation methodology is plainly inconsistent with section 137.122[.]" *Id*. at 375 n.25.

Consistent with Sansoucy's testimony, Respondent concedes that "[f]or the remand, Mr. Sansoucy did not attempt to separately identify economic obsolescence affecting the $53,252,400 original cost value, as set by the appellate court." *Respondent's Reply*, at 9. Instead, Sansoucy used a market extraction method based on comparable sales to estimate the depreciation to be deducted from the original cost. *Id*. at 11. Complainant, however, notes Sansoucy made no adjustments among the comparable sales and failed to subtract goodwill and working capital from the selected sale prices. Respondent claims Sansoucy fully rebutted these issues, and asserts "Sansoucy demonstrated a greater understanding of the gas utility industry and gas utility industry sales than any witness in the case." *Id*. at 12. The Commission, as the finder of fact, is not persuaded by Sansoucy's testimony.

In contrast to Sansoucy, Complainant's appraiser, Reilly, did not contest the court's clear directions on remand. Reilly developed a credible depreciation analysis and determined the total depreciation for January 1, 2013 tax date was $28,031,000. Fully two-thirds of this depreciation ($19,624,000) stemmed from physical deterioration. Reilly calculated physical deterioration by considering a 2008 depreciation study and accumulated depreciation reported to the PSC and Federal Energy Regulatory Commission as an estimate of the physical depreciation. While Reilly attributed $19,624,000 of the $28,031,000 in total depreciation to physical deterioration, Respondent's application for review does not challenge Reilly's physical deterioration analysis or calculation. Respondent, therefore, leaves Reilly's calculation of $19,624,000 in physical deterioration wholly unchallenged while requesting that the Commission find the subject property depreciated by only $6,390,288. While the Commission reviews the Hearing Officer's decision de novo, the necessity of specifically raising an issue for the Commission's review "is implicitly embodied in the statutory requirement that the application for review . . . 'shall contain specific detailed grounds upon which it is claimed the decision is erroneous.'"  *Tibbs v. Poplar Bluff Assocs. I, L.P*., 411 S.W.3d 814, 820 (Mo. App. 2013) (quoting section 138.432). While not dispositive, Respondent's wholesale failure to challenge the bulk of Reilly's depreciation analysis or calculation substantially undermines Respondent's position.

Respondent's application for review focuses on the claim that Reilly's calculation of economic obsolescence was flawed. Respondent argues Reilly's economic obsolescence analysis was based on the erroneous assumption Complainant was earning lower rates of return. Respondent asserts Complainant's rate of return on its rate base was over 9%. Reilly, however, credibly testified the estimation of economic obsolescence under the cost approach looks to whether the utility is earning a fair rate of return, and not its rate of return on the rate base. Reilly produced credible evidence showing Complainant's net operating income return on net gas utility plant varied from 4.6% to 7.1% in the five years prior to 2013. The rates of return were less than the 8.06% rate of return authorized by Missouri Public Service Commission.

As noted, Reilly quantified economic obsolescence with three applications of the capitalization of income loss depreciation method. These three approaches indicated economic obsolescence ranging from 13% to 42%. The average economic obsolescence was 29%, and the median was 32%. Reilly reconciled the results and concluded economic obsolescence was 25%, yielding a total depreciation of $28,031,000.

Respondent asserts there is no evidence showing how the 13% economic obsolescence Reilly attributed to Complainant can be reconciled to 25% economic obsolescence. Respondent's singular focus on the 13% economic obsolescence ignores the fact Reilly's analysis indicated economic obsolescence of up to 47%, a 29% mean, and a 32% median. These calculations indicate Reilly's 25% economic obsolescence calculation was a prudent, conservative estimate based on three accepted appraisal methods.

Next, Respondent claims Reilly's economic obsolescence was "not based on any of the four enumerated factors in the Hearing Officer's findings of fact." This claim is a variant of Respondent's claim that the Commission should reverse the Hearing Officer's decision and order because the Hearing Officer's findings were allegedly insufficient. As previously stated in this Decision, the Hearing Officer’s findings of fact were sufficient in that they provide an explanation and basis for the Hearing Officer’s decision.

The Commission's findings, in conjunction with the findings and evidentiary record detailed in the Hearing Officer's decision and incorporated herein, detail substantial and persuasive evidence supporting Reilly's economic obsolescence calculation. Reilly considered four factors.

First, as set forth in the Commission's findings of fact, Reilly determined the legally allowed rate of return was decreasing. In 2008, the industry wide rate of return was of 10.42%. By 2012, the industry wide rate of return decreased to 9.94%. The decreasing rate of return supports a finding of economic obsolescence.

Second, Reilly determined investor owned utilities were generally failing to earn their allowed rates of return. The fact utilities were not earning the allowed rate of return supports a finding of economic obsolescence.

Third, Reilly determined increased competition, weather conditions, and higher energy efficiency standards negatively affected Complainant's return. Reilly noted that from 2008 through January 1, 2013, Complainant's operating income decreased at an annualized rate of 8.8%. This persistent, significant decrease in operating income supports a finding of economic obsolescence.

Finally, Reilly determined the overall industry outlook was negative. For instance, Standard & Poor's noted a negative outlook for the natural gas industry due to the utilization of alternative energy sources to satisfy increased demand. Reilly also noted Complainant's gas distribution system was incurring additional costs as consumer demand declined. The negative industry wide decrease in operating income supports a finding of economic obsolescence.

The foregoing four factors supported Reilly's conclusion the subject property was affected by economic obsolescence. As explained above, Reilly quantified the percentage of economic obsolescence and reconciled his results to determine an overall economic obsolescence of 25%. The record includes substantial and persuasive evidence supporting Reilly's analysis and results.

While Reilly's analysis and calculations were persuasive, this does not mean his approach is beyond critique. Determining a reasonable estimate of economic obsolescence requires analysis of multiple factors. In many cases, like this one, no one factor definitively proves of the existence or extent of economic obsolescence. By the same token, a relative lack of evidence supporting a relevant factor typically does not disprove economic obsolescence. Instead, appraisers gather a range of data relevant to value, quantify the effect of that data on value, and, ultimately, utilize informed professional judgment and experience to reconcile the often less than perfectly precise results. Moreover, Reilly's approach complied with the court of appeals' directions on remand to determine depreciation according to the cost approach. Reilly did so, and the Commission finds his testimony and depreciation estimate both credible and persuasive.

Consistent with the directions in the Court’s order on remand, the Hearing Officer conducted a hearing in which the parties presented evidence as to the amount of depreciation to be deducted from original costs of $53,252,400. The Hearing Officer determined that Complainant presented substantial and persuasive evidence establishing the total amount of depreciation to be deducted was $28,031,000 for a resulting TVM as of January 1, 2013, of $25,221,400. The Commission finds that a reasonable mind could have conscientiously reached the same result as the Hearing Officer based on a review of the entire record. *Hermel, Inc. v. STC*, 564 S.W.2d 288 (Mo. 1978); *Black v. Lombardi*, 970 S.W.2d 378 (Mo. App. E.D. 1998).

## ORDER

The Decision of the Hearing Officer is AFFIRMED. The Decision and Order of the Hearing Officer, including the findings of fact and conclusions of law therein, is incorporated by reference, as if set out in full, in this final decision of the STC.

Section 138.432 and sections 536.100 to 536.140 govern judicial review of the Commission's decision and order. If Assessors seek timely seeks judicial review within thirty days, any protested taxes presently in escrow as a result of this appeal shall be held pending a final decision of the courts, unless disbursed pursuant to section 139.031.8.

If judicial review is not sought within thirty days, this decision and order is deemed final and the county collector, and the collectors of all affected political subdivisions, shall disburse the protested taxes presently held in escrow in accordance with the decision on the assessment underlying this appeal.

SO ORDERED July X, 2020.

STATE TAX COMMISSION OF MISSOURI

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Gary Romine, Chairman

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Victor Callahan, Commissioner

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Will Kraus, Commissioner

**Certificate of Service**

I certify that copy of the foregoing has been sent electronically or mailed postage prepaid on July X, 2020, to:

Elaina McKee

Legal Coordinator

1. The Hearing Officer's decision and order is incorporated as if fully set forth herein. [↑](#footnote-ref-1)
2. The Commission has authority to decide this appeal. Section 138.432 RSMo 2000. Section 138.432 authorizes the Commission to “affirm, modify, reverse, or set aside the decision and order of the Hearing Officer[.]” All statutory citations are to RSMo 2000, as amended. [↑](#footnote-ref-2)
3. When, as in this case, the Commission's decision incorporates the Hearing Officer's decision, a court reviews the Commission's decision as including the Hearing Officer's decision.  *Rinehart,* 363 S.W.3d at 363; *see also Loven v. Greene Cty*., 94 S.W.3d 475, 477 (Mo. App. 2003). [↑](#footnote-ref-3)
4. The "substantial and competent" evidence standard is drawn from section 536.140.2(3), which governs judicial review of a final agency decision in a contested case. The Commission reviews record de novo to determine if there is substantial and persuasive evidence supporting the Hearing Officer's decision. [↑](#footnote-ref-4)