

Exhibit No. _____
Issue: Maintenance and Repair, Electrical
Service Fee, Audit and Tax Preparation,
Corporate Allocations, MERIC Determination of
Payroll as a Part of Corporate Allocations,
Bank Analysis Fees, Compliance with
Commission Orders
Witness: Phil Macias
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Indian Hills
Case No.: WR-2017-0259
Date: October 27, 2017

Missouri Public Service Commission

Rebuttal Testimony

of

Phil Macias

On Behalf of

Indian Hills Utility Operating Company, Inc.

October 27, 2017

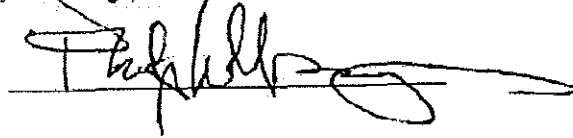
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date 11-27-17 Reporter 4F
File No WR-2017-0259

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AFFIDAVIT

STATE OF MISSOURI)
)
COUNTY OF St. Louis) ss

I, Phil Macias, state that the answers to the questions posed in the attached Rebuttal Testimony are true to the best of my knowledge, information and belief.



Subscribed and sworn to before me this 27 day of October, 2017.


Notary Public

My Commission Expires: 01/31/2021

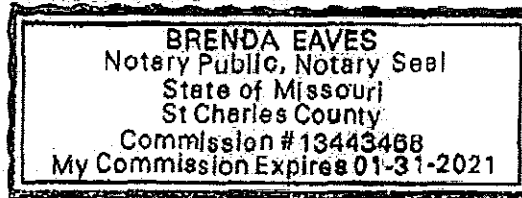


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REBUTTAL TESTIMONY OF
PHIL MACIAS
INDIAN HILLS UTILITY OPERATING COMPANY, INC.

WITNESS INTRODUCTION

1

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Phil Macias. My business address is 500 Northwest Plaza Drive
4 Suite 500. St. Ann MO, 63074

5 **Q. WHAT IS YOUR POSITION WITH INDIAN HILLS UTILITY OPERATING**
6 **COMPANY, INC. (INDIAN HILLS OR COMPANY)?**

7 A. I hold the position of Chief Financial Officer of First Round CSWR, LLC, the
8 ultimate parent company of Indian Hills, which is managed by Central States
9 Water Resources, Inc. We collectively refer to the family of companies ultimately
10 managed by Central States Water Resources, Inc. as Central States Water
11 Resources, CSWR, and Central States.

12 **Q. Are you the same Phil Macias that provided direct testimony in this**
13 **proceeding?**

14 A. Yes.

15 **Q. What is the purpose of your rebuttal testimony?**

16 A. The purpose of my rebuttal testimony is to respond to the direct testimony of Ms.
17 Ashley Sarver, witness for the Staff of the Missouri Public Service Commission
18 on Treatment of Repair and Maintenance Expenses, Corporate Allocations, and
19 Corporate Allocations in regards to payroll and treatment of tax and audit fees;

1 Mr. Greg Myer, witness for the Missouri Office of the Public Counsel ("OPC") on
2 bank analysis fees; Mr. John Robinett, witness for the OPC, on the capitalization
3 of leak repairs and categorization electrical investment; and, Ms. Keri Roth,
4 witness for the OPC on commission orders, audit and tax fees, and use of
5 MERIC for corporate job responsibilities and experience levels.

6
7 **MAINTENANCE AND REPAIR EXPENSE**

8 **Q. DOES INDIAN HILLS CONTINUE TO DISAGREE WITH THE COMMISSION**
9 **STAFF AND OPC IN REGARD TO ITS PROPOSED TREATMENT OF**
10 **MAINTENANCE AND REPAIR EXPENSE?**

11 A. Yes. We disagree with the Staff and OPC's recommendations as reflected in the
12 Direct Testimony of Staff Witness Jennifer Grisham and OPC Witness John
13 Robinett.

14 **Q. WHAT RECOMMENDATIONS DID THOSE WITNESSES MAKE?**

15 A. These witnesses recommended the amortization of most of the leak repair
16 expense Indian Hills has incurred.

17 **Q. WHY DO YOU DISAGREE WITH THE RECOMMENDATIONS?**

18 A. The repairs in question do not represent new capitalized investments, but rather
19 they were fixes inside antiquated, critical water infrastructure and, as described in
20 the Rebuttal testimony of Todd Thomas, they are expected to continue for the
21 foreseeable future. As such, they are part of our on-going operational
22 requirement to provide safe, reliable service.

23 **Q. WHAT IS THE APPROPRIATE TREATMENT OF THIS ISSUE?**

1 A. Costs related to normal, on-going maintenance should be recognized as such
2 and not capitalized. The proper treatment for activity characterized as
3 maintenance and repair is to ensure the expense is recorded in the period
4 incurred and reflected in the Company's revenue requirement at the level it is
5 expected to be incurred going forward. Amortization is inappropriate. In fact, if
6 maintenance and repair expenses included in the revenue requirement were
7 updated to reflect actual expenses from the current year (12 months ended
8 09/17), which more fully covers the period when the new plant additions were in
9 operation, they would total \$189,300 (See my Direct Testimony Schedule PM-1).
10 This amount accurately reflects the Company's actual costs.

11 **Q. WHAT AMOUNT SHOULD THE COMMISSION INCLUDE IN INDIAN HILLS'
12 REVENUE REQUIREMENT FOR MAINTENANCE AND REPAIR EXPENSE?**

13 A. \$99,303.

14 **ELECTRICAL SERVICE FEE**

15 **Q. STAFF WITNESS JENNIFER GRISHAM INDICATES THAT THE COSTS
16 ASSOCIATED WITH COSTS TO INSTALL AN ELECTRIC SERVICE
17 UPGRADE SHOULD BE TREATED AS RATE BASE. DOES THE COMPANY
18 AGREE WITH STAFF'S PROPOSED TREATMENT OF THESE COSTS?**

19 A. Yes. Staff correctly categorizes the electrical service upgrade for which Indian
20 Hills paid Crawford Electric. Mr. Thomas will testify further on why this electrical
21 service upgrade is a net benefit to the customers.

22 **Q. WHAT DOES OPC PROPOSE IN REGARD TO THESE COSTS?**

23 A. OPC Witness Robinett proposes to amortize these costs over a five-year period.

1 Q. HOW SHOULD THE COST OF THE ELECTRICAL IMPROVEMENT BE
2 TREATED?

3 A. Account 325 of the USOA is used to capture the cost of electrical pumping
4 equipment, including installation. The initial service fee was nonrefundable, a
5 permanent improvement to the water system, and was an ordinary and
6 necessary cost directly associated with the building of the new well, booster
7 pumps, ground storage, and well house. USOA Account 325 is described as
8 follows: *"This account shall include the cost installed of pumping equipment*
9 *driven by electric power."* The items listed in USOA Account 325 are:

- 10 1. Motors for driving pumps.
- 11 2. Pumps, including setting, gearing, shafting and belting.
- 12 3. Water piping within a station, including valves.
- 13 4. Auxiliary equipment for motors and pumps such as oiling systems, cooling
14 systems, condensers, etc.
- 15 5. Electric power lines and switching.
- 16 6. Regulating, recording and measuring devices.
- 17 7. Foundations, frames and bed plates.
- 18 8. Ladders, stairs and platforms if a part of pumping unit.

19 The electrical equipment associated with Indian Hills is item USOA item #5-
20 Electrical power lines and switch. Accordingly, this electrical line improvement
21 should be appropriately recorded in Account 325, as Staff Witness Ms. Grisham
22 states.

23

1 **AUDITING AND INCOME TAX PREPARATION FEES**

2 **Q. DOES THE COMPANY CONTINUE TO DISAGREE WITH THE COMMISSION**
3 **STAFF AND OPC IN REGARD TO AUDITING AND TAX PREPARATION**
4 **FEES?**

5 **A.** Yes. Staff Witness Ashley Sarver excluded both the audit and tax preparation
6 fees for Indian Hills and the pro-rata share of audit & tax preparation fees from
7 First Round in her Direct Testimony. OPC Witness Roth excluded both the audit
8 and tax preparation fees for Indian Hills and the pro-rata share of audit fees from
9 First Round and allowed for a small portion of tax fees from First Round in her
10 Direct Testimony.

11 **Q. WHAT IS INDIAN HILLS' ANNUAL SHARE OF THOSE COSTS?**

12 **A.** Indian Hill's direct costs of \$13,750 (\$10,000, financial audit and \$3,750, tax
13 preparation) combined with a 18% allocation of CSWR's audit and tax fees of
14 \$13,750, 18% of which is \$2,475, for a total \$16,225.

15 **Q. HAS ANYTHING CHANGED SINCE YOUR DIRECT TESTIMONY WAS FILED?**

16 **A.** Since the submission of direct testimony, the third party financial audit of Indian
17 Hills has been completed for Fiscal Year 2016. Audits have also been completed
18 for Raccoon Creek Utility Operating Company, Inc., Hillcrest Utility Operating
19 Company Inc., and First Round CSWR, LLC for fiscal years 2015 & 2016. The
20 invoices for all of these audit and tax preparation services have been provided to
21 the Staff. These invoices have been attached as **Schedule PM-1R-C.**

22 **Q. WHAT IS THE APPROPRIATE TREATMENT OF THIS ISSUE?**

1 A. The Commission should order that Indian Hills' tax fees, Indian Hills' audit fees,
2 and Indian Hills' corporate allocation of the actual audit and tax preparation fees
3 of First Round CSWR, LLC and Central States Water Resources, Inc. be
4 included in Indian Hills' revenue requirement. These expenses are known,
5 measurable, and part of best practices for a utility company.

6
7 **CORPORATE ALLOCATIONS**

8 Q. WHAT DISAGREEMENT DOES INDIAN HILLS HAVE WITH THE
9 COMMISSION STAFF IN REGARD TO THE STAFF'S PROPOSED
10 TREATMENT OF CORPERATE ALLOCATIONS?

11 A. The Staff uses a flawed methodology for the determination of corporate
12 allocations.

13 Q. WHAT IS FLAWED ABOUT THE STAFF ALLOCATION METHODOLOGY?

14 A. The Staff incorrectly makes capital adjustments to create allocations and the
15 Staff incorrectly allocates indirect hours.

16 Q. WHAT IS INCORRECT ABOUT THE STAFF'S CAPITAL ADJUSTMENTS?

17 A. Staff reduced labor expense by 10% by applying an estimated capitalization rate.
18 This is improper. First it assumes that each employee contributed 10% of their
19 labor to capital related efforts. That assumption is unreasonable. For example,
20 zero percent of the customer service labor is related to construction. Likewise,
21 not all accounting team members are involved in capital projects. Because Staff
22 was unable to establish a direct labor hour to capital project relationship, they
23 used the ratio of operations & maintenance (O&M) expense to CSWR payroll

1 (PR) expense. However, by definition, this ratio is not capital related. It is O&M
2 to PR, not capital to PR. Capital and O&M are two distinctly different functional
3 activities and there is no reasonable basis to assume that one ratio in any way
4 approximates the other. The inability to develop and apply a genuinely capital
5 based rate does not legitimize the use of an improper alternative.

6 **Q. WHAT IS INCORRECT ABOUT THE STAFF'S ALLOCATION OF INDIRECT**
7 **HOURS?**

8 A. The methodology used to calculate Staff's proposed 16.61% overhead allocation
9 rate did not consistently use actual, individual employee/position hours for 3 of
10 the six team members. For 3 other employees/positions, the method also used
11 calculations containing key elements that were estimated by staff rather than
12 being based on actual labor hour data. The staff model includes a complete
13 labor hour data set for each individual employee/position and uses a series (5) of
14 successive calculations (designed for use with the data set), with each
15 calculation building on the previous result. While the model includes the requisite
16 detailed information for each position, staff declined to consistently use it for all
17 positions and we disagree with that decision. Rather than use the actual data at
18 hand, staff inserted averages of different combinations of employees/positions in
19 selected calculations and declined entirely to use data from the tables they
20 prepared for subsequent calculations. For example, for 3 of the 6
21 employees/positions, the actual individual regulated company to total company
22 (i.e. non-administrative) ratios ranged from 99.6% to 100% but staff used
23 93.13%. This is the result of incorrectly using an averaged (company-wide) total

1 as the denominator. For two additional positions the actual ratios were 90.4%
2 and 100% but staff used 66.67%. For the last employee/position, the actual ratio
3 was 79.81% and staff instead used 50%. In other words, the staff replaced
4 actual results from their model with different and less favorable values. Staff has
5 proposed an allocation rate of 16.6%. However, inputting actual individual
6 employee/position values derived from staff's data table into the model provides
7 an allocation rate of 17.6%.

8 **Q. IF YOU CORRECTLY IMPLEMENT STAFF'S METHODOLOGY AND UTILIZE**
9 **ACTUAL HOURS WHAT ALLOCATION DO YOU CALCULATE?**

10 A. Using actual hours for each employee following Staff's methodology, the
11 resulting corporate allocation is 17.6%

12 **Q. WHAT IS THE APPROPRIATE TREATMENT OF THIS ISSUE?**

13 A. A per customer allocation is an accurate and more reasonable method of
14 allocation. This would result in an 18% allocation for IH, and would be consistent
15 with the other CSWR allocations currently in place.

16
17 **MERIC DETERMINATION OF PAYROLL**

18 **AS A PART OF CORPORATE ALLOCATIONS**

19 **Q. WHAT ISSUES DOES INDIAN HILLS HAVE WITH THE COMMISSION STAFF'S**
20 **UTILIZATION OF MISSOURI DEPARTMENT OF ECONOMIC DEVELOPMENT**
21 **(MERIC) FOR EMPLOYEE SALARY?**

22 A. In the Direct Testimony of Staff Witness Ashley Sarver, the Staff utilizes the
23 MERIC data to determine job classifications and experience levels. The Staff is

1 correct in the job classification used for all but one CSWR employee, but has
2 made mistakes in the application of MERIC. Mr. Thomas will testify about the
3 Staff's job classifications.

4 **Q. WHAT MISTAKE HAS THE COMMISSION STAFF MADE IN THE**
5 **UTILIZATION OF MERIC FOR EMPLOYEE EXPEREINCE LEVEL?**

6 A. As Mr. Thomas will describe in detail, Staff has mistakenly misapplied MERIC
7 data. MERIC defines "entry" level wages as the average of the lower one third of
8 wages for a job classification. A MERIC "Experience" level is the average of the
9 upper two thirds of employees for a job classification. MERIC "Mean" level wages
10 are the average of all wages for a given job classification. MERIC experience
11 level classifications are broken into two parts. An employee is either in the
12 bottom one third for a given position or the upper two thirds for designation
13 purposes. This type of classification rounds down the very top earners while still
14 allowing measurable reported salary numbers to dictate experience levels.
15 MERIC's unbiased salary measurement allows market forces to determine the
16 level of industry experience an individual possesses in a given year. Staff
17 incorrectly tries to assign mean experience levels for the Company President, the
18 Company Senior Vice President (misclassified by Staff per Testimony by Mr.
19 Thomas), the Company Customer Service Manager, and the Company's Senior
20 Accountant. This Staff assigned "Mean" experience level designation does not fit
21 MERIC's methodology which is based on CSWR employees being above the
22 33.3 percentile of individuals inside a given job classification.

1 **Q. WHAT OTHER ISSUES DOES INDIAN HILLS HAVE WITH THE COMMISSION**
2 **STAFF'S MERIC UTILIZATION?**

3 A. Staff incorrectly used different data years for different employees. Staff used
4 2013 employment wages for the President and Customer Service Manager, while
5 2015 employment wages were used for the four remaining employees.
6 Consistent, reliable and accurate results require the use of a consistent analytical
7 methodology. In addition to using different data years, Staff used out-of-date
8 data for all employees. The fundamental purpose for the MERIC is to
9 continuously research and assess labor market conditions to provide policy
10 makers and the public with accurate, up-to-date and useful information. Staff
11 witness Sarver states on page 5 of her Direct Testimony that the MERIC data
12 used for the President and Customer Service Manager has been updated 3 times
13 since 2013. Data for each of the remaining positions has been updated once.

14 **Q. WHAT METHODOLOGY SHOULD BE USED IN THE APPLICATION OF**
15 **MERIC TO COMPANY EMPLOYEES?**

16 A. MERIC studies occupational groups by region in Missouri bi-annually, using
17 actual job responsibilities, using actual wages page to create a benchmark for
18 experience and salary levels. Since Staff opts to rely on MERIC data, the most
19 currently available (MERIC 2016) data should be used and it should be used
20 uniformly for all employees. We believe the appropriate SOC codes and Titles
21 are:

22 11-1011 - Chief Executive – Experienced

23 11-3031 - Financial Manager – Experienced

1 11-1021 – General and Operations Manager – Experienced

2 11-9199 – Customer Service Manager - Experienced

3 **Q. HOW DOES OPC WITNESS (MS. ROTH'S) APPLY MERIC TO THE**
4 **COMPANY'S EMPLOYEES?**

5 A. Ms. Roth correctly applies the most currently available (MERIC 2016) study year
6 uniformly across all CSWR employees. However, Ms. Roth incorrectly tries to
7 create job classifications based on her opinion of the company size and her
8 opinion of company performance. Ms. Roth then arbitrary assigns a mean salary
9 level which has no connection to actual salaries paid by the firm.

10 **Q. DOES MERIC CONTEMPLATE THE USE OF COMPANY SIZE OR**
11 **PERFORMANCE IN THE ASSIGNMENT OF TITLES?**

12 A. No. The data is provided based on actual responsibilities and without regard to
13 company size or other factors.

14 **BANK ANALYSIS FEES**

15 **Q. IN HIS DIRECT TESTIMONY, OPC WITNESS MEYER STATES THAT HE IS**
16 **NOT AWARE OF ANY ANALYSIS THAT IS PERFORMED IN REGARD TO**
17 **THE BANK ANALYSIS FEES CHARGED TO THE COMPANY. WHAT ARE**
18 **THE BANK ANALYSIS FEES?**

19 A. The phrase "bank analysis fee" is a (banking) industry term for what is essentially
20 an invoice detailing the charges incurred during the month. For Indian Hills, the
21 largest portion of the monthly bill is for lockbox services. The Company maintains
22 "lockbox" accounts at Enterprise Bank and Trust. The bank analysis fees
23 included by the Staff for rate making purposes are \$4,932 or \$411 per month.

1 **Q. WHY WOULD A COMPANY UTILIZE THIS TYPE OF SERVICE?**

2 A. A lockbox account is a commonly used business and banking service where the
3 bank directly receives payments from a company's customers and records the
4 cash receipts on behalf of the company. In the case of Indian Hills, there are
5 several advantages. By having payments sent directly to the Company's bank,
6 the payments are processed much faster which increases the pace of cash flow.
7 Further, as a general rule, banks typically employ much more ridged process
8 controls than their clients which reduces the inherent risks associated with cash
9 receipts. Using the lockbox allows Indian Hills to take advantage of that process.
10 The lockbox is also a valuable tool for the Company because we receive a high
11 quantity of low dollar payments the processing of which is a time consuming and
12 labor-intensive process. By contracting for only the exact amount of (labor
13 related) expense required to complete this function, the Company avoids any
14 additional costs not directly associated with servicing Indian Hills customers.

15 **Q. ARE THESE LOCKBOXES A PART OF INDIAN HILLS' STANDARD**
16 **OPERATING PROCEDURE?**

17 A. Yes. The use of lockboxes has been a part of the Indian Hills, and all of our
18 operating utilities, from the beginning of the business.

19 **Q. HAS THE STAFF BEEN AWARE OF THIS PRACTICE?**

20 A. Yes. In fact, the use of Indian Hill's lockbox was specifically mentioned in the
21 Staff's CAMU "Report Of Customer Service and Business Operations Review
22 Memo". In the *Payment Remittance* Section, the CAMU Memo Staff states "Most
23 payments are received in the mail at the lockbox at the bank,..."

1 **Q. HOW ACCURATE ARE BANK LOCKBOXES?**

2 A. They are very accurate. For example, in the month of September 2017, the
3 lockbox for Indian Hills processed 449 transactions and the lockboxes for all
4 CSWR companies processed 1,165 transactions. There were no errors in the
5 deposits. That level of accuracy has been our standard experience over the last
6 2.5 years of using this system.

7 **Q. WHAT SHOULD THE COMMISSION DO IN REGARD TO THIS ISSUE?**

8 A. The Commission should recognize Lockbox fees (otherwise known as Bank
9 Analysis Fees) in Indian Hills' revenue requirement as the Staff proposes.

10 **COMPLIANCE WITH COMMISSION ORDERS**

11 **Q. WHAT ALLEGATIONS DOES OPC WITNESS ROTH MAKE ABOUT**
12 **PREVIOUS COMMISSION ORDERS?**

13 A. Ms. Roth believes that Indian Hills did not comply with several Commission
14 Orders in the original WO-2016-0045 financing case regarding reporting of the
15 initial issuance of debt to Indian Hills, violation of debt covenants, use of Indian
16 Hills debt, and changes to the Indian Hills investment structure.

17 **Q. WHAT RESPONSE DO YOU HAVE ABOUT THE USE OF DEBT PROCEEDS?**

18 A. Ms. Roth's statement is inconsistent with the supporting documentation included
19 with her testimony. Ms. Roth references the statements of OPC witness Meyer
20 and that the OPC was unable to prove that all funds from the financing
21 agreement were used as ordered in case WO-2016-0045. However, in line one
22 of the second page of supporting accounting documents for Ms. Roth's
23 Testimony titled, "Rate Base & Required Return on Investment Schedule –

1 Water," the Plant in Service is valued at \$1.86 million, which is well in excess
2 (\$400K) of the original \$1.45 million principal debt amount. OPC's own valuation
3 as presented in the schedule shows the OPC was able to prove the financing
4 related funds were used as ordered.

5 **Q. WHAT RESPONSE DO YOU HAVE AS TO ALLEGED DEBT COVENANT**
6 **VIOLATIONS?**

7 A. As CFO, I can say there are currently no debt covenant violations with the Indian
8 Hills loan. It's also important to note that Indian Hill's independent auditors also
9 attested to the fact there are no debt covenant violations in their 2016 Audit
10 Report.

11 **Q. WHAT RESPONSE DO YOU HAVE ABOUT REPORTING ON CHANGES TO**
12 **THE INVESTMENT STRUCTURE OF INDIAN HILLS OR ITS AFFLIATE**
13 **INVESTORS?**

14 A. We disagree with the assertion that there was a change in investment structure
15 under the purview of para 22 of the Order in WO-2016-0045. Given that Indian
16 Hills Utility Operating Company, Inc., through its parent, Indian Hills Utility
17 Holding Company, Inc. is wholly owned by First Round – CSWR, and that equity
18 infusions were from First Round CSWR only, the investment framework has
19 remained consistent. In addition, there has been no change to the investment
20 structure per the financing agreement.

21 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

22 A. Yes, it does.

SCHEDULE PM-1R-C

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