

Exhibit No.:

*Issues: Corporate Payroll;
Audit Costs & Tax
Preparation Fees;
AFUDC Rate*

Witness: Paul R. Harrison

Sponsoring Party: MoPSC Staff

Type of Exhibit: Rebuttal Testimony

Case No.: WR-2016-0064

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MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

AUDITING DEPARTMENT

REBUTTAL TESTIMONY

OF

PAUL R. HARRISON

Hillcrest Utility Operating Company, Inc.

CASE NO. WR-2016-0064

Jefferson City, Missouri

May 2016

**** Denotes Highly Confidential Information **** **PR**

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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **PAUL R. HARRISON**

4 **HILLCREST UTILITY OPERATING COMPANY, INC.**

5 **CASE NO. WR-2016-0064**

6 Q. Please state your name and business address.

7 A. Paul R. Harrison, P. O. Box 360, Jefferson City, Missouri 65102.

8 Q. By whom are you employed and in what capacity?

9 A. I am a Regulatory Auditor with the Missouri Public Service Commission
10 (“PSC” or “Commission”).

11 Q. Are you the same Paul R. Harrison who has previously filed direct testimony
12 in this proceeding?

13 A. Yes, I am.

14 **PURPOSE OF TESTIMONY**

15 Q. What is the purpose of your rebuttal testimony for this case?

16 A. The purpose of my rebuttal testimony in this case is to address The Office of
17 Public Counsel (“OPC”) witness Keri Roth’s direct testimony concerning corporate
18 payroll and Hillcrest Utility Operating Company, Inc. (“Hillcrest” or “Company”) witness
19 Josiah Cox’s direct testimony concerning corporate payroll, audit costs and tax preparation,
20 and Allowance for Funds Used During Construction (AFUDC) rate.

21 **CORPORATE PAYROLL COMPENSATION**

22 Q. What is OPC’s position concerning corporate payroll?

1 A. For purposes of assessing the Company's salary levels, as shown within
2 Schedule KNR-4 HC, Ms. Roth asserts that the job category of Mr. Cox, the President of the
3 Company, should be assumed to be "General and Operations Manager" and that the job
4 category of Mr. Jack Chalfant, the Chief Financial Officer (CFO) of Hillcrest should be
5 assumed to be "Accountants and Auditors." She then recalculated their pay based on the most
6 current Missouri Economic Research and Information Center (MERIC) "mean" rate shown
7 for those job categories.

8 Q. Do you agree with OPC that the MERIC job categories applicable to Mr. Cox
9 and Mr. Chalfant should be changed to "General Manager" and "Accountant and Auditors,"
10 respectively?

11 A. No. The corporate structure of Central States Water Resources (CSWR) was
12 established in order to acquire multiple troubled water and sewer entities in Missouri. CSWR
13 has already acquired three systems and is planning to purchase more troubled systems, so that
14 it can make the necessary mandated Missouri Department of Natural Resources ("DNR")
15 improvements to the systems. In the near future, CSWR will likely need to hire more
16 employees in order to maintain the operations of Hillcrest and the other acquired utilities. At
17 the present time, Hillcrest is only absorbing 14% of the corporate allocated costs, including
18 payroll, and the other 86% of corporate costs are being allocated to the corporate level or to
19 other utilities under CSWR's management. Given the nature of CSWR's current and
20 projected operations in the state of Missouri, Staff's position continues to be that the job
21 categories it employed to analyze the level of salary expense properly allocated to Hillcrest
22 for CSWR's corporate employees are appropriate, as reflected in my direct testimony filed in
23 this matter.

1 Q. Is the information shown in Ms. Roth's Schedule KNR-3 HC comparing other
2 water and sewer systems to Hillcrest and CWSR supportive of OPC's position on corporate
3 payroll costs?

4 A. No. The other small water and sewer systems that OPC is referring to in
5 Schedule KNR-3 HC are all single standalone entities, and are not comparable to Hillcrest
6 and CWSR.

7 Q. Are there other payroll issues that OPC has with Staff's treatment of corporate
8 payroll costs for CSWR in this case?

9 A. Yes. Ms. Roth states the following in her direct testimony at page 6, lines 4
10 through lines 8, concerning Mr. Cox's work on Hillcrest:

11 OPC believes any hours worked prior to the closing date of the assets,
12 March 13, 2015, should be reallocated to non-regulated business
13 activities. Therefore, OPC has adjusted its calculation to ** _____ **
14 hours annually. OPC strongly recommends the Commission order
15 CSWR employees to provide specific descriptions on their timesheets
16 of the duties performed during hours worked for all regulated utilities
17 under CSWR.

18 Q. Does Staff agree with OPC that all hours worked prior to the closing date of
19 the assets, March 13, 2015, should be reallocated to non-regulated business activities?

20 A. No, not entirely. Staff agrees that the costs associated with all hours worked
21 prior to March 13, 2015 should not be included in Mr. Cox's annualized payroll expense;
22 however, Staff believes that all the cost associated with the hours worked prior to the
23 acquisition date of Hillcrest, should be capitalized into plant in service and included as part of
24 Hillcrest's rate base.

PR

1 Q. What is Hillcrest's position concerning corporate payroll?

2 A. Mr. Cox states the following in his direct testimony at page 15, lines 21
3 through page 16, line 7:

4 Hillcrest finds the Staff's general approach to be acceptable. However,
5 in working through that process, the Commission should use
6 Employment Cost Index EPI inflation adjusted salaries for experienced
7 personnel at each category for rate making purposes.

8 All the salaries should be adjusted using the EPI in order to accurately
9 reflect current market conditions, rather than utilizing data that is two
10 years old. Moreover, in the case of the Central States employees, each
11 employee's actual experience, education levels, and current job roles
12 demand that the individual be recognized as "experienced."

13 Note: Mr. Cox also refers to the Employment Cost Index as EPI in his testimony.

14 Q. Do you agree with the Company that the MERIC pay rate for CSWR should
15 be factored up to reflect the current market condition, rather than utilizing data that is
16 "two years old?"

17 A. No. The data that Staff used for MERIC was taken from calendar year 2014
18 and the update period for this case ended October 31, 2015; therefore, the data was less than
19 one year old as of the cut-off date for this case.

20 Q. Do you agree with the Company that the CSWR employees' MERIC level of
21 pay should be established at the "experienced" level instead of the "mean" level?

22 A. No. At the time Staff developed the cost of service for Hillcrest, the CSWR
23 employees had only seven months of experience providing the management, accounting
24 and administration duties of a regulated utility and the Company was just beginning to
25 establish itself as a regulated utility. In addition, Hillcrest is a relatively small Company with
26 only 241 water customers and 240 sewer customers. When and if CSWR acquires more
27 systems, gains more experience and achieve its goal of becoming a larger utility company,

1 it may be appropriate at that time to re-evaluate the level of compensation for the CSWR
2 employees.

3 Q. Are there any other issues concerning payroll that need to be addressed in your
4 rebuttal testimony?

5 A. Yes. It has come to Audit Staff's attention that we inadvertently left out the
6 capitalized portion of Mr. Cox's operation and maintenance (O&M) payroll in rate base for
7 this case. To correct this error, Staff in coordination with the Company, has increased
8 Hillcrest's water and sewer plant accounts by \$5,438.08. Staff's updated workpapers
9 reflecting this change will be provided to all parties assigned to this case.

10 **CSWR AND HILLCREST AUDIT COSTS AND TAX PREPARATION FEES**

11 Q. What is the Company's position concerning CSWR and Hillcrest audit costs
12 and tax preparation fees (i.e., accounting costs) for this case?

13 A. The Company witness, Mr. Cox, states in his direct testimony on page 20,
14 lines 3 through lines 13 that:

15 The Company issued requests for proposals (RFP) and circulated those
16 RFP's to a variety of accountants and accounting firms in order to
17 determine the least expensive qualified firm for rate making purposes.

18 For tax preparation services at Hillcrest, the lowest qualified cost is
19 \$6,000 per year. For audit services at Hillcrest, the lowest qualified cost
20 is \$11,000 per year. For tax preparation services at Central States, the
21 lowest qualified cost is \$4,850 per year. For audit services at Central
22 States, the lowest qualified cost is \$10,000.

23 Q. When will the Company be incurring the cost for this expense?

24 A. The Company indicated that they had already hired an accounting firm and it
25 would be completing the audit and 2015 tax preparation work sometime this summer or
26 possibly fall, which will be after this case, has been completed. This time period is eight to

1 ten months after the update period for this case ended. In addition, the Company did not send
2 out request for proposals for these services until January 2016, three months after the end of
3 the update period for this case.

4 Q. What is Staff's position regarding the CSWR and Hillcrest accounting costs for
5 this case?

6 A. Staff is recommending that the "known and measurable" amount that the
7 Company actually paid for accounting costs during the test year and update period should be
8 included in this case.

9 Q. What is the actual amount of accounting costs that Staff has included in
10 this case?

11 A. Staff has included \$336 in this case, split 50/50 between water and sewer. This
12 is 14% of the actual amount of corporate accounting costs that Hillcrest paid for and booked
13 for the test year and update period.

14 Q. If Staff does not include these costs in its cost of service and the Company
15 incurs its projected level of costs in the summer or fall of this year, how can the
16 Company obtain rate relief for these cost increases?

17 A. Per the Partial Disposition Agreement, within 12-18 months after the effective
18 date of an Order approving the Partial Disposition Agreement, it is agreed that either Staff
19 will initiate a rate review or the Company shall file a rate case in order to develop a cost of
20 service based upon additional actual revenue and expense incurred beyond the applicable
21 period of time available to Staff in this case. The actual costs incurred for the accounting fees
22 and property taxes can be addressed at that time when they are known and measurable, along
23 with all other concurrent changes in the Company's cost of service.

1 **ALLOWANANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC) RATE**

2 Q. What is AFUDC?

3 A. AFUDC represents the carrying cost incurred to finance capital projects during
4 the construction period.

5 Q. What is the Company's position concerning AFUDC rate for this case?

6 A. Mr. Cox states in his direct testimony on page 30, lines 1 through lines
7 10, that:

8 Staff used the hypothetical debt rate discussed above in his testimony
9 for its AFUDC determination.

10 AFUDC should be calculated based on the actual loan terms associated
11 with the money borrowed by the Company.

12 Q. What is the AFUDC rate used by Staff in this case?

13 A. Staff used the cost of debt of 6.60% that was provided by Staff witness
14 Shana Griffin of the Staff Financial Analysis Unit to calculate the carrying costs for
15 Hillcrest's water and sewer construction projects.

16 Q. Is this AFUDC rate subject to change in this case?

17 A. Yes. The weighted cost of debt is one of the issues that is being litigated in
18 this case and, if the Commission orders a different rate be used than the rate recommended by
19 Staff in this proceeding, then the Commission-ordered debt rate should be used in the
20 calculation of the AFUDC carrying costs in this case.

21 Q. Does this conclude your rebuttal testimony?

22 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Water Rate Increase)
Request of Hillcrest Utility Operating)
Company, Inc.) Case No. WR-2016-0064

AFFIDAVIT OF PAUL R. HARRISON

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

COMES NOW Paul R. Harrison and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing Rebuttal Testimony; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

Paul R. Harrison
Paul R. Harrison

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 11th day of May, 2016.

DIANNA L. VAUGHT
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: June 28, 2019
Commission Number: 15207377

Dianna L. Vaught
Notary Public