

*Exhibit No.:*  
*Issue:* Rate of Return/Capital  
Structure  
*Witness:* Shana Griffin  
*Sponsoring Party:* MoPSC Staff  
*Type of Exhibit:* Rebuttal Testimony  
*Case No.:* WR-2016-0064  
*Date Testimony Prepared:* May 11, 2016

**MISSOURI PUBLIC SERVICE COMMISSION**

**COMMISSION STAFF DIVISION**

**AUDITING DEPARTMENT**

**REBUTTAL TESTIMONY**

**OF**

**SHANA GRIFFIN**

**HILLCREST UTILITY OPERATING COMPANY, INC.**

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

Jefferson City, Missouri  
May 2016

\*\* Denotes Highly Confidential Information \*\*

**NP**

1  
2  
3  
4  
5  
6  
7  
8  
9

**TABLE OF CONTENTS**  
**OF THE REBUTTAL TESTIMONY OF**  
**SHANA GRIFFIN**  
**HILLCREST UTILITY OPERATING COMPANY, INC.**  
**CASE NO. WR-2016-0064**

EXECUTIVE SUMMARY ..... 1

RESPONSE TO MR. COX’S DIRECT TESTIMONY ..... 2

SUMMARY AND CONCLUSIONS ..... 17



1 hypothetical capital structure recommendation. I will also address Mr. Cox's disagreement  
2 with Staff's cost of debt recommendation.

3 **RESPONSE TO MR. COX'S DIRECT TESTIMONY**

4 Q. What return on common equity (ROE) did Mr. Cox recommend for Hillcrest  
5 in his direct testimony?

6 A. Mr. Cox did not provide a recommended ROE in his direct testimony. The  
7 only statement Mr. Cox makes about ROE is on page 22, line 1 of his direct testimony in  
8 which he states: "In this case, Hillcrest's debt is at a higher cost than its return on equity."  
9 Based on this statement, it appears that Mr. Cox accepts that the allowed ROE should be  
10 below 14%.

11 Q. According to his direct testimony, what capital structure did Mr. Cox  
12 recommend for Hillcrest?

13 A. Mr. Cox states that the Commission should use Hillcrest's actual capital  
14 structure.

15 Q. Does Mr. Cox provide his actual recommended capital structure for Hillcrest  
16 in his direct testimony?

17 A. No. Mr. Cox only discusses Hillcrest's capital structure in a general sense.  
18 On page 24, lines 10-12, of his direct testimony, Mr. Cox states, "The capital structure  
19 Hillcrest is utilizing is the only structure that could be found. Moreover, this is the same  
20 structure Hillcrest presented to Commission in its acquisition and financing application."

21 Q. What capital structure does Staff recommend in this proceeding?

22 A. As stated in Staff's direct testimony, Staff is recommending a hypothetical  
23 capital structure consisting of 25% equity and 75% total debt. Staff's hypothetical capital

Rebuttal Testimony of  
Shana Griffin

1 structure recommendation is based on Staff's understanding that Mr. Cox fully intended to  
2 use a high amount of traditional third-party debt financing to fund the investment needs at  
3 Hillcrest.

4           Although Mr. Cox represented to Staff that his intent was to issue debt in excess of  
5 75% of total capital at the utility, as detailed in Staff's "Small Utility Return on  
6 Equity(ROE)/Rate of Return (ROR) Methodology," attached as Schedule SG-d2 to my direct  
7 testimony, Staff's methodology limits the amount of debt for practical purposes. At least in  
8 theory, a capital structure that contains an extreme amount of leverage will have so much  
9 financial risk that the equity investors' required return will be exponentially higher than what  
10 would be expected under a more prudent capital structure. Staff chose 75% debt as the limit  
11 because S&P's benchmark capital structures for a "Highly Leverage Profile" starts at 60%  
12 debt and although it does not indicate a limit, Staff knows from practical experience that  
13 publicly traded utility companies rarely have a leverage ratio greater than 75%. Although it  
14 could be argued that the limit should be less than 75% debt, Staff does not want to  
15 completely ignore an extremely leveraged position by allowing an equity ratio that is not  
16 consistent with how the company is truly capitalized. Hypothetical ratemaking capital  
17 structures that contain more equity than a company's actual capital structure may encourage  
18 companies to be too aggressive with the use of leverage in an attempt to achieve higher  
19 returns.

20           Q.     Mr. Cox states in his direct testimony that Staff utilized a debt cost of 9.88%.  
21 Is this correct?

22           A.     No.

Rebuttal Testimony of  
Shana Griffin

1 Q. What cost of debt did Staff recommend for Hillcrest in its direct testimony?

2 A. As explained in Staff's direct testimony, Staff's initial cost of debt  
3 recommendation was 8.88% but presently Staff considers a cost of debt range of 8.88% to  
4 10.13% to be fair and reasonable based on a capital structure of 75% debt and 25% equity.  
5 Staff recommended a range on the cost of debt due to a rapid increase in junk bond yields in  
6 early 2016. Although Staff believes the tightening of junk bond capital markets should be  
7 considered in the allowed ROR, Staff also emphasizes that these higher yields have not been  
8 typical over the last five years.

9 Q. What cost of debt did Mr. Cox recommend for Hillcrest in his direct  
10 testimony?

11 A. Mr. Cox recommended a cost of debt of 14%. Mr. Cox states that this is  
12 Hillcrest's actual cost of debt. Due to the complexity of the investment structure set up for  
13 investment in Hillcrest, the lack of transparency and access to information from the lone  
14 monetary capital investor of Hillcrest both through Fresh Start Venture LLC (Fresh Start)  
15 and First Round CSWR, LLC (First Round) as well as all of the various affiliations of the  
16 investors known to Staff, Staff does not trust that the 14% rate resulted from good faith  
17 negotiations. Traditionally, most traditional debt rates are determined by applying a margin  
18 to some set index, based on the creditworthiness of the borrower. Staff can not verify that  
19 the 14% has been set in this manner. Even in other private placement financing transactions  
20 submitted to the Commission for approval, the cost of the senior debt was a function of some  
21 margin over a recognized index.

22 The investors providing the capital as "debt financing" to Hillcrest also provide all of  
23 the financial equity capital to Hillcrest. (See HC Schedule SG-d5 of my direct testimony)

1 Although the owners of Fresh Start, \*\* \_\_\_\_\_ \*\*  
2 provided all of the monetary capital, Mr. Cox has been assigned a 13% equity interest in First  
3 Round CSWR, LLC because he brought the investment opportunity to the capital investors  
4 and he is responsible for deploying the capital and managing it, hence the reason Central  
5 States Water Resources, Inc. (CSWR) has been named the Manager as defined in “Amended  
6 and Restated Operating Agreement of First Round CSWR, LLC Dated As Of March 5,  
7 2015.” Staff considers the investment structure set up by Mr. Cox and his investors to be  
8 very similar to that of the strategy behind a private equity investment involving a general  
9 partner (the “idea” person and manager) and a limited partner (the financial capital). In fact,  
10 other utilities in Missouri have been organized and run under similar strategies.<sup>1</sup> The only  
11 individual and/or entity that is disadvantaged by the structure of the Fresh Start contract is  
12 Josiah Cox and CSWR because the contract ensures that Mr. Cox’s equity partners receive a  
13 return on and of capital first.

14 If Hillcrest were to default on the 14% financing agreement, then the investors that  
15 own the debt and 87% of the equity interest in Hillcrest through First Round, \*\* \_\_\_\_\_  
16 \_\_\_\_\_ \*\* would simply become the wholly owned investors due  
17 to the most likely scenario that Mr. Cox’s equity interest would be deemed worthless. As a  
18 result of all of these issues and concerns, Staff estimated a cost of debt based on junk bond  
19 debt yields from published indices that Staff is confident are a function of third-party debt  
20 investors’ market requirements.

21 Q. On pages 7 and 8 of Mr. Cox’s direct testimony he discusses Hillcrest’s  
22 acquisition of the water and sewer systems from Brandco Investments, LLC (Brandco), in

---

<sup>1</sup> See Southern Missouri Natural Gas, Case No. GF-2007-0215

Rebuttal Testimony of  
Shana Griffin

1 File No. WO-2014-0340. He explains that Hillcrest closed on the transaction on March 13,  
2 2015, after Hillcrest's proposed financing was examined "in great detail" and the  
3 Commission filed an order on October 22, 2014, which approved the Stipulation and  
4 Agreement and granted a certificate of convenience and necessity. Have the investors  
5 identified in Hillcrest's acquisition and financing case changed since Staff reviewed the  
6 information in that case?

7 A. Yes. Although the Fresh Start contract is still binding, through some type of  
8 transaction(s) apparently executed between the current owners of Fresh Start Venture,  
9 \*\* \_\_\_\_\_ \*\* and the original investors. \*\* \_\_\_\_\_  
10 \_\_\_\_\_ \*\* are now the sole financial investors in the systems that  
11 are managed by Mr. Cox through the original agreement between Fresh Start and First  
12 Round.

13 Q. Has Staff seen the purchase agreement executed between the current owners  
14 of Fresh Start Venture, \*\* \_\_\_\_\_ \*\* and the original  
15 investors?

16 A. No.

17 Q. When was Staff notified in writing about the change in ownership?

18 A. Mr. Cox sent Staff an email on September 9, 2015, with an attached letter that  
19 summarized the change in investors (See Schedule SG-r1-HC).

20 Q. When did Mr. Cox provide the final financing agreement between Hillcrest  
21 and Fresh Start that identified \*\* \_\_\_\_\_ \*\* as the  
22 investors?

23 A. In November 2015.

**NP**



Rebuttal Testimony of  
Shana Griffin

1 Q. According to the Stipulation and Agreement and the Commission's Order in  
2 Case No. WO-2014-0340, was Mr. Cox required to file the final executed agreement with the  
3 Commission?

4 A. Yes, condition number 13 of the approved Stipulation and Agreement in Case  
5 No. WO-2014-0340<sup>2</sup>, required Hillcrest to file with the Commission the final executed loan  
6 agreement within ten days of execution.

7 Q. When was the financing agreement between Hillcrest and Fresh Start  
8 executed?

9 A. The financing agreement between Fresh Start and Hillcrest was executed on  
10 March 6, 2015. Although it does not appear that Mr. Cox was statutorily required to seek  
11 Commission approval for the change in investors supporting these significant capital  
12 expenditure programs for these target utilities, as Mr. Cox explained in his testimony, Staff  
13 attempted to scrutinize the commitment and potential affiliation of the original investors  
14 before Staff recommended approval of the acquisition of the Brandco system. Staff  
15 understood that the planned capital expenditures would result in significant rate increases for  
16 the customers of this system. Consequently, Staff took this matter very seriously.  
17 Considering the significance of Staff's concern, Staff was certainly surprised when Mr. Cox  
18 failed to reach out to Staff in a timely manner to specifically discuss this significant change,  
19 even if after the fact. If Hillcrest had fulfilled its agreed-to requirement to file the final  
20 executed loan agreement, the fact that the original proposed investors were not the ones who

---

<sup>2</sup> Condition 13 of the approved Stipulation and Agreement in Case No. WO-2014-0340: 13. Hillcrest is required to file with the Commission within ten (10) days of the issuance of any financing authorized pursuant to a Commission order in this proceeding, a report including the amount of indebtedness issued, date of issuance, interest rate (initial rate if variable), maturity date, redemption schedules or special terms, if any, use of proceeds, estimated expenses, and the final executed loan agreement;

1 signed the loan agreement would have been brought to light and Staff would have been  
2 afforded an opportunity to discover this change even without specific notice from Mr. Cox.  
3 Staff could then have had the opportunity to examine the change in investors in a timely  
4 manner after the financing was executed.

5 Q. Has Staff received responses to all of its Data Requests filed in this matter?

6 A. No. Responses to Staff Data Request Nos. 14 to 16 are overdue. Staff is  
7 seeking the board minutes or similar materials from either First Round or any of the affiliated  
8 companies created in conjunction with the investments in the utility systems. The absence of  
9 this information causes Staff much concern about the legitimacy of the proposed financial  
10 returns Hillcrest seeks to charge its customers.

11 Q. Has Staff inquired with Mr. Cox regarding the outstanding data request  
12 responses?

13 A. Yes. Mr. Cox responded under oath to Staff in his deposition<sup>3</sup> on April 28,  
14 2016 that he would provide responses to these outstanding data requests.

15 Q. What did Staff's investigation reveal about the change in investors providing  
16 capital for Hillcrest Utility Operating Company Inc. through various affiliates?

17 A. Currently the overall ownership structure is as follows: Hillcrest Utility  
18 Operating Company, Inc., which holds the utility assets, is wholly owned by Hillcrest Utility  
19 Holding Company, Inc., which is wholly-owned by First Round CSWR, LLC, which is  
20 managed by Central States Water Resources, Inc. (CSWR).

21 Based on information originally presented to Staff in Hillcrest's acquisition and  
22 financing case, Staff understood that CSWR would be the holding company for all of the

---

<sup>3</sup> Deposition of Josiah Cox Taken On Behalf of Office of the Public Counsel April 28, 2016, Page 135, line 3, through page 138, line 22.

Rebuttal Testimony of  
Shana Griffin

1 utility companies acquired by CSWR with Mr. Cox owning 51% of CSWR's stock and the  
2 remaining 49% owned by \*\* \_\_\_\_\_ \*\*. First Round was  
3 not identified to Staff as part of the ownership structure until September 2014, approximately  
4 5 months after Hillcrest filed its financing and certificate case. Mr. Cox indicated that he had  
5 to assign 33% non-voting equity interest in Hillcrest to Fresh Start in order to lower the  
6 stated rate on the financing agreement to 14% from 15%. Although the term sheet provided  
7 to Staff in that case indicated the 33% ownership interest was in Hillcrest Utility Operating  
8 Company, a later communication from the Company indicated that the 33% ownership  
9 interest was actually in First Round. Staff is still seeking information to clarify how this  
10 arrangement was ultimately executed through its Data Request No.0029.1, which requests the  
11 original First Round operating agreement.

12 The current version of the First Round operating agreement does not list Fresh Start  
13 as owning any membership Units. However, \*\* \_\_\_\_\_ \*\*, which is owned  
14 by \*\* \_\_\_\_\_ \*\*, owns 87% of the Member Units in  
15 First Round. \*\* \_\_\_\_\_ \*\* also own Fresh Start through  
16 their company, \*\* \_\_\_\_\_ \*\*. \*\* \_\_\_\_\_ \*\* and \*\* \_\_\_\_\_ \*\*  
17 are both owned through trusts. Although CSWR doesn't own anything, it is Staff's  
18 understanding that \*\* \_\_\_\_\_ \*\* also acquired \*\* \_\_\_\_\_ \*\* interest  
19 in CSWR. Mr. Cox owns 13% of the Member Units in First Round and CSWR owns less  
20 than a hundredth of a Unit (.01) in First Round. It is Staff's understanding that the Fresh  
21 Start financing agreement was not renegotiated when \*\* \_\_\_\_\_  
22 \_\_\_\_\_ \*\* bought Fresh Start.

Rebuttal Testimony of  
Shana Griffin

1           Staff understands why an investor would find attractive the 14% rate assigned to the  
2 Fresh Start contract. The fact that this rate didn't change when the new investors acquired  
3 87% equity interest in First Round and all of Fresh Start's interest does not make sense from  
4 a risk and return perspective. Mr. Cox allotted 33% equity interest to the original investors in  
5 order to try to lower the interest rate on the Fresh Start contract. However, now that there are  
6 new investors, which own 87% of First Round equity and all of Fresh Start, the rate hasn't  
7 changed. This is because the negotiations to finance Hillcrest were not arms-length  
8 transactions. Staff's understanding is that Fresh Start was created specifically to provide  
9 financing for this investment opportunity pursuant to a contractual agreement. Fresh Start is  
10 not a chartered bank regulated by state or federal banking authorities. It was formed in 2014  
11 and was initially capitalized with \$1.785 million by a group of 12 equity investors.<sup>4</sup> Fresh  
12 Start's investors all had some previous business affiliation with \*\* \_\_\_\_\_  
13 \_\_\_\_\_ \*\*. Because of the unique circumstances surrounding the proposed investment  
14 structure and affiliations between the proposed debt investor, Fresh Start, and two of the  
15 equity investors of Hillcrest, Staff had concerns that the 14% rate was not a result of a good  
16 faith negotiation, as is normally the case with passive debt investors. Consequently, Staff  
17 explicitly indicated that its recommended approval of the proposed financing arrangement  
18 was not an endorsement of this rate as fair and reasonable for purposes of setting Hillcrest's  
19 allowed return. Due to the change in Hillcrest's investors, now the debt and equity investors  
20 are the same, which validates Staff's concerns.

**NP**

---

<sup>4</sup> United States Securities and Exchange Commission Form D Notice of Exempt Offering of Securities, filed on February 17, 2014.

Rebuttal Testimony of  
Shana Griffin

1 Q. What are the unique circumstances surrounding the investment structure?

2 A. The investment structure does not involve a traditional third-party debt  
3 relationship. On paper Mr. Cox portrayed the investment structure as a corporation with  
4 initially three, now two, equity investors with a separate and passive debt investor. However,  
5 considering Fresh Start's large monetary capital investment of approximately 77% of total  
6 planned capitalization, it appears that Fresh Start's investment is more similar to the strategy  
7 employed by a limited partner in a private equity arrangement in which the limited partner  
8 invests the monetary capital and the general partner, in this case CSWR and Josiah Cox,  
9 invests and manages the capital with potential upside if he is successful in generating  
10 significant returns. Limited partners typically prefer to leverage their returns by issuing debt  
11 capital. Staff does not know how Hillcrest's investors are capitalizing their investments in  
12 both Fresh Start and \*\* \_\_\_\_\_ \*\*.

13 Q. Has Mr. Cox explained why a private equity investor would contribute both  
14 debt and equity capital to the same investment under a limited partnership agreement?

15 A. Yes. In response to Staff data request No. 0037 in Case No. WO-2014-0340,  
16 Mr. Cox states \*\* \_\_\_\_\_

17 \_\_\_\_\_  
18 \_\_\_\_\_  
19 \_\_\_\_\_

20 \_\_\_\_\_ \*\* This illustrates that the 14% indicated return is more  
21 similar to a negotiated rate often performed by a limited partner attempting to subordinate the  
22 partner that has not contributed the monetary capital, i.e. the general partner. In such  
23 situations, the partner providing this capital is simply ensuring that they receive any cash

1 flow before any other equity interests. Hence, this capital may simply be viewed as a  
2 different class or form of an equity investment. In such situations, the partner that  
3 subordinated the other partner does not actually expect to receive cash payments on  
4 scheduled payment due dates, but rather credit for these amounts will accrue to the limited  
5 partner and will be required to be paid before other equity interests receive distributions.

6 Q. Why didn't Hillcrest structure the proposed investment as a limited  
7 partnership arrangement?

8 A. It is Staff's understanding that Mr. Cox believed the Missouri Public Service  
9 Commission would not allow this structure. However, certain utilities in Missouri have been  
10 authorized by the Commission under this type of structure, such as Southern Missouri  
11 Natural Gas Company. The response to Staff's Data Request No. 0034 in Case No.  
12 WO-2014-0340 states \*\* \_\_\_\_\_  
13 \_\_\_\_\_  
14 \_\_\_\_\_  
15 \_\_\_\_\_  
16 \_\_\_\_\_  
17 \_\_\_\_\_  
18 \_\_\_\_\_  
19 \_\_\_\_\_

20 \_\_\_\_\_ \*\*

21 Q. Does the above answer indicate that the Commission would not allow such a  
22 structure?

Rebuttal Testimony of  
Shana Griffin

1           A.     No. It simply indicates that Staff communicated to a prospective capital  
2 investor that if the investor issued debt to fund its equity investment, Staff would investigate  
3 and potentially recommend that the investor's allowed rate of return be set based on the cost  
4 of debt supporting the equity investment.

5           Q.     As I stated in rebuttal testimony in Case No. WO-2014-0340, Staff had a  
6 meeting with a representative of \*\* \_\_\_\_\_ \*\*. If Staff had only discussed  
7 potential ratemaking considerations in a limited partnership arrangement with the  
8 potential investor, does this mean Staff indicated the Commission would not allow this  
9 investment structure?

10          A.     No.

11          Q.     How has the investment structure of the Company affected Staff's  
12 investigation?

13          A.     Up to this point, Staff has not been able to "look through" the various  
14 investment entities to determine how these investments are capitalized. Staff's main concern  
15 about accepting 14% as a market-based cost is the fact that this utility employs such a  
16 complex investment structure that is not transparent and consists of non-traditional  
17 affiliations between investors.

18          Q.     Could Hillcrest currently be viewed as having a capital structure of  
19 100% equity?

20          A.     Yes. The equity investor and the debt investor are the same investor. The  
21 introduction of leverage into a capital structure is supposed to make the equity investors'  
22 return less certain. However, because Fresh Start Venture provides all of the capital, the  
23 return on that capital would be looked at in total.

**NP**

Rebuttal Testimony of  
Shana Griffin

1 Q. Does any information corroborate Staff's view that the 14% rate assigned to  
2 the Fresh Start investment is essentially a preferred equity return rather than a function of  
3 third-party debt costs?

4 A. Yes. The preferred rate for the Members' Units in the First Round LLC  
5 agreement is also stated to be 14%. Therefore the return on the equity and debt is the same,  
6 which is inconsistent with basic risk and return concepts of the use of leverage.

7 Q. What ROR would Staff recommend if the Commission believes the  
8 circumstances support 100% equity treatment of the capital provided by the investors?

9 A. 8.18%.

10 Q. How does Staff's ROR recommendation for Hillcrest compare to other ROR  
11 recommendation made by Staff for small water and sewer companies in the state of  
12 Missouri?

13 A. Staff's proposed ROR in this matter is the highest since Staff started using its  
14 current small utility methodology in September 2010.<sup>5</sup> This comparison took into  
15 consideration all the small water and sewer companies, including companies in receivership,  
16 that filed for a rate increase from September 2010 to present.

17 Q. Mr. Cox claims on page 25 of his direct testimony that "Small, distressed  
18 water and wastewater systems are shut off from traditional capital markets." Are there small  
19 water and sewer companies in the state of Missouri that have received loans from traditional  
20 commercial banks?

21 A. Yes. However, it is true that some of the owners of these companies have  
22 provided personal guaranties from their owners. Staff takes these personal guaranties into

---

<sup>5</sup> Staff did recommend a ROR of 10.03% in a receivership case in which the company withdrew its rate increase request.



1 consideration when assessing the business risk of these companies. Although owners are not  
2 necessarily legally required to provide personal guaranties, many do so in order to secure  
3 reasonably priced financing for the benefit of their customers. Based on some of the  
4 rejection letters Mr. Cox provided to Staff that CSWR received from commercial banks<sup>6</sup>,  
5 CSWR's owners were unwilling to provide personal guaranties.

6 Q. Mr. Cox states on page 27 in his direct testimony that he has continued to seek  
7 traditional debt financing and has continued to be rejected. Does Hillcrest's current  
8 financing agreement with Fresh Start allow for Hillcrest to refinance that agreement?

9 A. No. Section 6.15 of the Fresh Start loan agreement specifically prohibits  
10 Hillcrest from issuing any additional debt. Also, the make whole premiums for any potential  
11 early retirement of the Fresh Start debt make it uneconomical to do so. Consequently, Staff  
12 does not understand the source of Mr. Cox's testimony on this matter.

13 Q. On pages 28 and 29 of his direct testimony, Mr. Cox claims Staff made  
14 technical mistakes in its calculations. Did Staff make any mistakes in its calculations of a  
15 fair and reasonable cost of debt rate for Hillcrest?

16 A. No. Mr. Cox implies that Staff is recommending Hillcrest should attempt to  
17 seek a credit rating from a rating agency or that Hillcrest's debt could be traded in capital  
18 markets. Hillcrest is not a public entity. Staff's Small Utility Return on Equity (ROE)/Rate  
19 of Return (ROR) Methodology<sup>7</sup> allows Staff to estimate the risk of small non-publicly traded  
20 utility companies in a "transparent and verifiable" way, as cited by the Commission in the

---

<sup>6</sup> Some of the bank rejection letters that Mr. Cox provided state the name Dynamic Water Resources, LLC instead of Central States Water Resources, Inc. However, it is Staff's understanding that Dynamic Water Resources, LLC was the beginning of Mr. Cox's plan to acquire and recapitalize small water and sewer utilities and it later developed into Central States Water Resources, Inc.

<sup>7</sup> See Capital Structure Determination discussion on pages 4 and 5 of Staff's Small Utility Return on Equity (ROE)/Rate of Return (ROR) Methodology attached to Staff's direct testimony (Schedule SG-d2)

Rebuttal Testimony of  
Shana Griffin

1 Report and Order of Case No. WR-2013-0461. Staff is not insinuating that these small  
2 private utilities would be rated by any major credit rating agency. However, using S&P's  
3 financial benchmark of the Debt/Capital ratio allows Staff to estimate the financial risk of  
4 these non-publicly traded utilities. Staff estimates the business risk of these companies by  
5 evaluating their access to debt financing. Staff uses S&P's Business and Financial Risk  
6 Profile Matrix as a guide to find where these financial and business risks intersect so Staff  
7 can verify a fair and reasonable cost of debt and estimate a fair and reasonable ROE.

8 Q. Has Staff's Small Utility Return on Equity (ROE)/Rate of Return (ROR)  
9 Methodology been considered in other cases before the Commission?

10 A. Yes. Staff uses its Small Utility Return on Equity (ROE)/Rate of Return  
11 (ROR) Methodology ("methodology") to develop its recommendations for capital structure,  
12 cost of debt, ROE and ROR for all small water and sewer company rate increase requests. In  
13 most of these other requests, Staff has had little concern with using the companies' actual  
14 cost of debt because in almost all circumstances, the cost of debt has been easily in the single  
15 digit range.

16 In Case No. WR-2013-0461, capital structure and ROR were specifically litigated.  
17 Staff's methodology was determined in the Commission's Report and Order in Case No.  
18 WR-2013-0461 to be a "transparent and verifiable method for establishing a capital structure  
19 and measurement of a fair return on equity."

20 Q. Are Mr. Cox's recommendations for capital structure, cost of debt, ROE and  
21 ROR transparent and verifiable in this case?

22 A. No. Mr. Cox has not provided any calculations for a ROE recommendation in  
23 this case. Mr. Cox also has not provided any details supporting the 14% financing cost

1 assigned to the Fresh Start contract. Finally, Mr. Cox did not provide testimony on his  
2 recommended capital structure beyond stating Hillcrest's actual capital structure should  
3 be used.

4 Q. Do you think it would be helpful and perhaps reassuring to receive testimony  
5 and/or information directly from the investors in this case?

6 A. Yes. Clearly \*\* \_\_\_\_\_ \*\* are providing  
7 all of the financial capital to allow these investments to occur. In most cases in which ROR  
8 is debated, the Commission is trying to understand the view and requirements of a consensus  
9 of investors that are not identifiable. This situation is clearly different.

10 **SUMMARY AND CONCLUSIONS**

11 Q. Would you please summarize Staff's conclusions presented in your rebuttal  
12 testimony?

13 A. Yes. Staff's capital structure, cost of debt, ROE and ROR recommendations  
14 for Hillcrest are fair and reasonable. Mr. Cox did not provide his ROE recommendation in  
15 his direct testimony or any calculations pertaining to an ROE recommendation. The 14%  
16 interest rate charged to Hillcrest in the financing agreement between Hillcrest and Fresh Start  
17 is not a legitimate third party debt rate. All of Hillcrest's capital is being provided by a  
18 single investor which substantiates that the financing agreement is not an arms-length  
19 transaction.

20 Q. Does this conclude your rebuttal testimony?

21 A. Yes, it does.

**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 SHANA GRIFFIN**

STATE OF MISSOURI    )  
                                  )  
COUNTY OF COLE    )            ss.

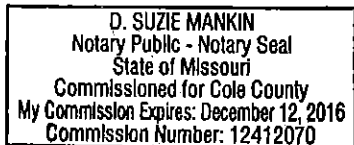
**COMES NOW** Shanna Griffin and on her oath declares that she is of sound mind and lawful age; that she contributed to the foregoing Rebuttal Testimony; and that the same is true and correct according to her best knowledge and belief.

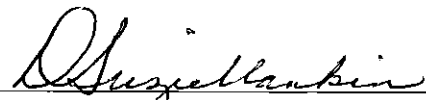
Further the Affiant sayeth not.

  
\_\_\_\_\_  
Shana Griffin

**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 11<sup>th</sup> day of May, 2016.



  
\_\_\_\_\_  
Notary Public

**SCHEDULE SG-r1**

**HAS BEEN DEEMED**

**HIGHLY CONFIDENTIAL**

**IN ITS ENTIRETY**