

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Liberty Utilities (Missouri) File No. WR-2018-0170
Water) LLC’s Application for a Rate Increase.) SR-2018-0171

Initial Brief of Liberty Utilities (Missouri Water) LLC

I. Introduction

Liberty Utilities (Missouri Water) LLC (“Liberty” or the “Company”) currently has water and wastewater operations in the Counties of Franklin, Jefferson, Cape Girardeau, Stone County, Taney, and McDonald. Though its operations are geographically widespread, the number of customers it serves is very small. There are approximately 2000 water connections and 400 sewer connections. (Schwartz, Exh. 1, p. 3) Because of its small size, Liberty filed a rate increase request under the Commission’s small utility rate procedure (“SURP”) rule on December 15, 2017, asking for an annual rate increase in operating revenues for its water systems of \$995,844 and \$196,617 (\$1,192,461 total) for its wastewater systems, a request driven by significant investments made to improve service since acquiring them and increases in O&M or operation and maintenance expenses since the last time rates had been adjusted. (Schwartz, Exh. 1, p. 3-4) The Company is also asking that the Commission consider a consolidation of rates for its Noel and KMB systems, both water and sewer. (Schwartz, Exh. 1, p. 8)

Staff undertook an audit of those systems and discussions took place to refine the numbers, to identify issues not in dispute and to resolve matters where there were differences. As a consequence, a Partial Disposition Agreement (“PDA”) was filed on

May 24th.¹ At the same time, Staff filed a request for an evidentiary hearing on outstanding issues.

No one in this case is disputing the fact that Liberty is significantly underearning.² Staff's analysis is that the incremental increase for water and sewer rates should be \$978,569. (Harrison, Exh. 106, p. 1-2) Based on Staff's revenue requirement and rate design analysis, Staff and the Company entered into a Nonunanimous Stipulation and Agreement ("Agreement") which was filed with the Commission on August 3, 2018. If adopted by the Commission, the Agreement will resolve all issues with the exception of rate case expense.³ Because no timely objection was filed to the Agreement and, pursuant to rule 4 CSR-240-2.115(2), the Commission may treat the terms of the Agreement as unanimous.

An evidentiary hearing was held on August 16, 2018, concerning the unresolved issues in this case. This brief will follow generally the organization and order of the issues as contained in the LIST OF ISSUES, ORDER OF WITNESSES, ORDER OF CROSS- EXAMINATION AND ORDER OF OPENING STATEMENTS filed on August 10, 2018. In a separate section of this brief below, Liberty will make its case for the adoption of the Agreement as a reasonable compromise resolution of the matters addressed therein.

¹ See, EFIS Doc. No. 34.

² See, EFIS Doc. No. 72. The Office of Public Counsel ("OPC") has filed no testimony on the topic of revenue requirement. Intervenors Silverleaf Resorts and Orange Lake Country Club (collectively "Silverleaf") and Ozark Mountain Condominium Association ("OMCA") have not undertaken a cost of service study or provided a recommendation as to overall revenue requirement in this case.

³ For purposes of organizing this brief, Liberty will first brief its positive case setting forth how the Commission should rule on all contested matters should it decide to not adopt the terms of the Agreement.

II. Cost of Service

Generally, Liberty has not taken issue with the *method* applied by Staff to arrive at Staff witness Paul Harrison's recommended revenue increase of \$978,569 set forth in his rebuttal testimony. This number, however, should be adjusted upward for a higher overall cost of capital than is reflected in Staff's calculation, which is addressed, *infra*. Liberty witness Jill Schwartz has estimated this impact as a +\$60,000 over Staff's case as-filed. (Exh. 1, p. 6-7)

Additionally, the final rates in this case should allow Liberty to recover an additional (as yet undetermined) amount in rates to cover its reasonable and prudent expenses to present its rate increase request to the Commission. This issue, too, will be addressed below along with the Company's recommendation of the appropriate period of time over which to recover these expenses.

a. Cost of Capital

i. Return on Equity

Keith Magee filed surrebuttal testimony in this case for Liberty addressing the appropriate return on equity ("ROE") to apply as a basis to determine the correct revenue requirement in this case.⁴ By application of the quarterly growth discounted cash flow

⁴ Silverleaf filed a motion to strike Mr. Magee's testimony alleging a failure by Liberty to timely notify Silverleaf that Mr. Magee had been hired as a cost of capital witness in the case. The Commission has taken that motion with the case. Liberty disputes this claim as groundless and, consequently, the motion to strike should be denied in the Report and Order. A copy of Liberty's response to the motion to strike is attached hereto and incorporated herein by reference. Additionally, the matters contained in Liberty's response are corroborated by Mr. Magee's testimony on August 16 when he stated that he had been engaged by Liberty just several weeks prior to the hearing. (Tr. 94)

(DCF) model, the capital asset pricing model (CAPM) and the risk premium model, Mr. Magee has testified that the Company's revenue requirement should be determined by use of a return on equity ("ROE") capital of 10.25% which is within a range of 9.90% to 10.35% representing the range of equity investors' required return for utilities having similar risk characteristics. This is consistent with the ROE proposed in the Liberty Utilities (Midstates Natural Gas) Corp.'s ("Midstates") rate case (File No. GR-2018-0013). (Schwartz Exh. 1, p. 6; Magee Exh. 4)

This recommendation is quite conservative. As recently as February of this year, the Commission awarded a 12% ROE to another small water company, Indian Hills Utility Operating Company.⁵ In the case of Missouri-American Water Company ("MAWC"), an entity with a much larger scale and scope of operations, the Commission recently adopted a settlement agreement whose revenue requirement was established within a range of 9.5 to 10%.⁶

Staff's filed position in this case is similar to that of the Company. Although its cost of capital witness, David Murray, indicates that one could calculate an ROE for Liberty as low as 7%⁷, he is recommending a 10% ROE which includes a 20 basis point adjustment from the 9.8% ROE recently awarded by the Commission in the Spire Missouri case, File No. GR-2017-0215. (Murray, Exh. 109, p. 3) While a bit lower than Mr. Magee's recommendation, it is within his 9.90-10.35% range of reasonableness. (Magee, Exh. 4, p. 4)

⁵ Case No. WR-2017-0259, Report and Order dated February 7, 2018.

⁶ Case No. WR-2017-0285 in May of 2018.

⁷ Murray Exh. 110, p. 3.

The reliability of the testimony of Silverleaf witness William Stannard on ROE should be steeply discounted by the Commission. Mr. Stannard is not a credentialed rate of return expert. Unlike Mr. Murray (a CFA⁸) and Mr. Magee (a CFA and a CRRA⁹), Mr. Stannard is a Registered Professional Engineer.¹⁰ He has no academic background that would tend to give him any special insights concerning returns on equity capital,¹¹ and his actual experience dealing with cost of service has been almost exclusively with, or about, municipalities which do not issue stock into the marketplace to capitalize their operations. (Tr. 130) Additionally, his nearly exclusive reliance on information sourced from Duff and Phelps is not particularly indicative of returns for utilities in that it looks to corporate returns of non-regulated enterprises which lead to unreasonably low ROE estimates relative to returns allowed for utilities nationally. (Magee, Exh. 4, p. 18-20; Murray, Tr. 114) As such, his recommended ROE 7.97% is unreliable and entitled to little weight.

As to Silverleaf's allegation of a lower financial risk to the Company resulting from a more stable revenue stream recommended by Staff, fixed rate charges and other decoupling mechanisms are common among utilities nationwide, so Liberty's risk profile is comparable to the industry generally. Accordingly, no ROE adjustment is indicated. (Magee, Exh. 4, p. 21)

ii. Capital Structure

The Commission should employ Liberty's recommended capital structure of 53 percent equity and 47 percent long-term debt which is consistent with the cost of capital

⁸ Chartered Financial Analyst.

⁹ Certified Rate of Return Analyst.

¹⁰ Stannard Reb. Sch. A.; Tr. 128.

¹¹ He has a B.S. in Business Administration and a B.S. in Civil Engineering.

proposed in the Midstates's rate case (File No. GR-2018-0013) because gas utilities and water utilities generally have similar risk profiles. This capital structure reflects the appropriate cost of capital deployed for the purpose of providing safe and adequate service to the Company's water and wastewater companies. (Schwartz, Exh. 1, p. 6; Magee Exh. 4)

b. Rate case expense

Liberty has incurred, and continues to incur, expenses to process this rate case. These costs are necessary to identify and address matters in dispute and to present them for resolution by the Commission. The Company should be allowed to recover reasonable and prudent expenses incurred at least through September 11, 2018, when reply briefs are currently scheduled to be filed and by which time a majority of the costs will be captured. Liberty should be given a reasonable amount of time after that date to submit to Staff invoices for qualifying expenses.¹²

The Company has committed in its pre-filed testimony and in the filed Agreement to file another rate case within two years after the implementation of new rates in this case, so rate case expense as determined by the Commission should be normalized over a period of two years for purposes of setting rates in this case. (Schwartz Exh. 2, p. 5; Exh.

¹² Liberty anticipates that its rate case expense will be higher than originally anticipated despite its every effort to control it. The Company invoked the Commission's SURP in an effort to minimize rate case expense. Much of the expense has been driven by responding to Silverleaf. For example, Silverleaf noticed up Liberty witness Jill Schwartz for a deposition on August 3, an unprecedented move in a SURP case. Finally, the Company was obligated to respond to Silverleaf's motion to dismiss this case and motion to strike Mr. Magee's surrebuttal testimony, as well as a number of pleadings filed on the eve of the hearing.

3, p. 2) This will give Liberty a realistic opportunity to recover its rate case expense during the period of time new rates will be in effect.

The Commission should not order that rate case expense be normalized over a period of five years which is part of Staff's case-in-chief. This proposal does not square with its recommendation in this case that the Commission order the filing of a new rate case by Liberty within 18 to 24 months. (*Id.*) Additionally, if Liberty does file at month 24, it would not under Staff's proposal be able to recover the total rate case expense built into the rates established in this case because normalization does not allow for a carry-over into superseding rate schedules. (Harrison, Tr. p. 159) This deficiency can be addressed by ordering an amortization (instead of a normalization) of rate case expense along with the creation of a regulatory asset/liability for the over-under. That approach, however, would build in an inequity for new customers that may hereafter be brought into Liberty's operations, like those of Ozark International. They would end up being asked to carry the burden of a liability for expenses incurred before they ever received service from Liberty.

III. Customer Service Issues

A number of service quality issues were raised in this case, all of which are matters that Liberty takes very seriously. The Company's responses to those issues are set forth below.

a. Comments Posted on EFIS

Although the comments posted on electronic filing and information system ("EFIS") are not technically part of the record, Liberty witness Schwartz addressed them

generally in her direct testimony. Similarly, the Company chooses to address them in this brief.

Liberty has reviewed the comments on EFIS and has determined that several of the issues identified already were addressed prior to December of 2017 when the Company filed its rate case. Liberty believes customers have been contacted directly about their concerns. Most of the taste/smell comments are derivative of the Company adding chlorination systems to prevent bacterial contamination as a public health precaution. There is no indication that the levels of chlorine exceed MDNR-recommended levels. To the contrary, all indications are that the levels of chlorination employed by Liberty are at the lower end of the recommended treatment range.¹³ Ultimately, this appears to be simply a matter of customers noticing the change.

There were also some complaints about low water pressure. Liberty looked into this and is employing monitoring technology as well as installing generators to pressurized systems to provide water service during power outages. (Schwartz, Exh. 1, p. 9-12)

b. Service Quality Issues at Ozark Mountain Condominiums

OMCA filed the testimony of Don Allsbury who recited a number of service quality problems that he has encountered over a period of years. (Allsbury Exh. 401) Liberty believes the incidents have been, or in the process of being, resolved as is evidenced by the fact that he mentions only one incident in 2018 with the next most current incident occurring in 2015, long before this case was filed. Liberty believes the

¹³ See, Roos, Tr. 197.

water system is providing reliable service. (Schwartz Exh. 2, p. 6-8)¹⁴ That assessment is shared by Staff witness Roos who looked into the matter.

Liberty's impression is that OMCA has been dissatisfied with a contractor the Company had been using to provide service at that location. As a consequence, Liberty terminated its contract with that contractor and has taken day-to-day operational responsibilities in-house to provide for better accountability and efficiency. (Schwartz, Exh. 2, p. 7)

c. Testimony Taken at the Local Public Hearings.

A number of service-related issues were raised by customers at one or more of the local public hearings in Pineville, Branson and Pacific. Some of the matters brought up (i.e., chlorination, water pressure, etc.) were along the lines as those posted on EFIS and which are addressed above.

The Company became aware at the local public hearing in Branson that members of the Holiday Hills Condominium ("HHC") had inaccurate contact information for Liberty based on inaccurate information posted on HHC's website as well as on printed materials HHC had provided to its occupants. (Schwartz, Tr. 211-212) While this is unfortunate, Liberty reviewed its records and established that in October of 2015, each customer's bill included a special notice alerting them of a new customer service number to call. (Schwartz, Tr. 212-213, Exh. 5) As Ms. Schwartz testified, each customer's bill

¹⁴ In her rebuttal testimony, Ms. Schwartz recounts her follow-up with Paul Carlson, Liberty's operations manager, including a meeting between Mr. Carlson and Mr. Allsbury and a facilities walk-through at OMCA in February of 2018. (Exh. 2, p. 7) Instead of taking issue with this characterization of that meeting in surrebuttal testimony, OMCA did not dispute the nature of that meeting until the day of the evidentiary hearing. (Tr. 170-171) Consequently, it is fair to discount the credibility of Mr. Allsbury's August 16 testimony on this topic.

from that day to present has printed on it the correct number to call. (Tr. 222-224; Exh. 5)

There were also concerns raised regarding notification to customers of boil advisories/warnings. Liberty is putting in place new and improved protocols for notifying customers including the use of signboards and door hangers as well as tailoring notices to post on the Company's website, all in compliance with MDNR guidelines. A direct mail information card is in the works as well. (Schwartz Tr. 215-217) Other avenues are being explored (e-mail or text notifications) but each of those has special demands and limitations which need to be better understood before adopting them.

IV. Rate Design

After the filing of its rate increase request in December of 2017, the Company requested that Staff as part of its audit consider the consolidation of rates for water and wastewater systems for its customers in the former Noel and KMB operations.¹⁵ This request follows the rationale provided in a joint EPA/NARUC publication entitled "Consolidated Water Rates: Issues and Practices in Single-Tariff Pricing". (Schwartz, Exh. 1, p. 8-9) Moderation of rate increases, lowering of administrative costs, enhancing small system viability and compliance with drinking water standards are many of the advantages described in this publication. This Commission, like others around the country, has struggled to come up with policies to address the special challenges faced by small water and wastewater systems. Its SURP has been intended to control costs and bring a level of sophistication to ratemaking that smaller systems may not be able to

¹⁵ Consolidation of rules and regulations is addressed in the PDA.

provide on their own. Rate consolidation is another administrative tool to further the goal of making small systems viable going forward.

Staff in this case is recommending that the Commission follow district-specific pricing. As an alternative, Staff suggests that it could support consolidation of the KMB water and wastewater systems. (Barnes, Exh. 100, p. 7-8) Clearly, the Company would like for there to be more progress in this regard, but it would be agreeable with Staff's KMB-only rate consolidation compromise as *a minimum acceptable step*. This, with the understanding that Liberty will continue to advocate for a more comprehensive rate consolidation in future cases.

a. Phase-In of Rates

Silverleaf's rate phase-in proposal is not authorized by law. The Commission only has statutory authority to order a rate increase phase-in for electric utilities caused by an unusually large increase in rate base. *See*, 393.155 RSMo. There is no similar enabling legislation for water or wastewater utilities.

Even if the obvious unlawfulness of the proposal could be set aside, new rates in this case should not be phased-in for Holiday Hills, Ozark Mountain and Timber Creek service areas. Silverleaf's proposal would have the Company earning less than its revenue requirement for successive years and, additionally, it would not compensate it for the carrying costs associated with deferred revenues. Also, it will cause rather significant yearly changes and swings in customer bills which will only serve to cause more confusion and frustration than will a one-time transition to the new rate schedules based on the standard practice for implementing customer and commodity charges.

(Schwartz, Exh. 3, p. 5-6)

Further, Staff has proposed that Liberty be required to file another rate case within the next two years and the Company has indicated that it has no objection to doing so. Thus, phase-in rates over this shortened period of time would be difficult and nonsensical. For all of these reasons, Silverleaf's five-year rate phase-in proposal should be rejected.

b. What are the appropriate customer and commodity charges?

Generally, the Company does not contest the method employed by Staff to determine the appropriate customer or commodity charges for its various water and wastewater systems, however, those charges will need to be re-calculated depending on how the Commission ultimately rules on the outstanding revenue requirement issues (i.e., cost of capital and rate case expense).

The only party directly taking direct issue with Staff's determination of customer and commodity charges is Silverleaf which suggests that pricing signals affect consumer usage behavior which is true as an abstract matter. However, Silverleaf's pricing signal argument is extremely odd in light of the fact that its timeshare owners are not actually customers of Liberty who receive bills from it. Silverleaf is the customer taking service from the Company through approximately 370 meters and it recovers its cost for water or wastewater service from its members as part of a lump-sum maintenance fee (presumably along with other of its allocated costs of operation) which sends no usage signals whatsoever to any unit occupant/owner. (Stannard Tr. 275-278; Exh. 304)

V. Silverleaf Rate Case Exemption

Silverleaf should not be excluded from Liberty's next rate case. Liberty can only achieve fair and reasonable rates for all of its various systems and customers if all

revenues, expenses and investments are reviewed at the same time and to ensure the proper allocation of the costs of shared services and corporate overhead allocations.¹⁶ Additionally, the Company's longer term objective, as noted above, is to continue to move in the direction of rate consolidation of its water and sewer systems to achieve a more efficient management of costs for these smaller systems, so Silverleaf needs to be a part of that process. (Schwartz, Exh. 3, p. 3) Finally, the issue is premature and should not be decided at this time. The correct time to address this topic is at such time as Liberty files its next rate case.

VI. Approval and Adoption of the Terms of the Nonunanimous Stipulation and Agreement

On August 3, Staff and Liberty filed the Agreement which, as noted above, would resolve all outstanding issues in this case except for the revenue issue of rate case expense (both amount and amortization period). Staff counsel in opening statement indicated that Staff recommends a three-year amortization of rate case expense if the Commission adopts the Agreement. (Tr. 53) Liberty is agreeable to this approach as well.

No party timely filed an objection to the Agreement within the seven days provided by Commission rule 4 CSR 240-2.115(2) and with respect to that circumstance, Liberty incorporates by reference herein several pleadings it filed on August 13.¹⁷ The

¹⁶ Silverleaf's position in this case is perplexing. Once Liberty's Ozark International acquisition is complete, Liberty will have approximately 800 more customers over which to allocate the cost of shared services and corporate allocations. In the absence of substantial capital improvements to Silverleaf's system during the next few years, it seems more likely than not that this dynamic would work in its favor. (Schwartz, Tr. 288-289)

¹⁷ EFIS documents nos. 98, 99, and 100. One of those matters is Liberty's outstanding motion to strike OPC's response to the Agreement that has been taken under advisement along with the case. Beyond just being untimely, the submission of the

Company will not burden this brief by rearguing those points other than to echo Staff counsel's point in his opening statement that the Commission's rules should be followed. The practical consequence for this case is that the Commission may consider the Agreement to be a unanimous agreement for purposes of resolving this case.

Whether taken as unanimous or otherwise, the Agreement provides a reasonable and comprehensive basis for deciding the matters it addresses. The rates, rate design, revenue and rate base numbers all are anchored in the record and can be tied to the testimony of one or more witnesses who have testified in this case. The stipulated ROE is quite modest given the size of the Company and its financial and its operational risks and is within the range of ROEs testified to by Mr. Murray and Mr. Magee.¹⁸

OPC and other parties have indicated that the lack of a specified capital structure in the Agreement is a deficiency warranting its rejection, but the Agreement addresses cost of capital in *exactly the same manner* as the agreement that formed the basis for the recent settlement of the Midstates case, *an agreement that was signed by OPC*. (Magee, Tr. p. 100)¹⁹ There are good reasons the signatories may not want capital structure to be specified in a settlement. (Murray, Tr. p. 113) The fact that the Agreement is silent on this point is no reason for the Commission to reject the overall reasonableness of its terms.

affidavit of Keri Roth is an inappropriate effort to submit surrebuttal testimony out-of-time without a showing of good cause. Liberty's respectfully requests that its motion to strike be granted as part of the Commission's Report and Order in this case.

¹⁸ See, §II.a.i., *supra*.

¹⁹ That settlement *did* specify a 47:53 debt-to-equity capital structure for ISRS purposes. (*Id.*)

The Agreement addresses additional matters that further favor its adoption by the Commission.²⁰ It provides for the implementation of those matters contained in the PDA. It addresses ADIT treatment as a consequence of the Tax Cuts and Jobs Act of 2017. It specifies the billing determinates to be used for establishing customer rates. It addresses revenue requirement allocation as between operating systems. It provides for the consolidation of residential rates for KMB operations. It includes commitments by Liberty with regard to its books of account and the booking of cost of removal and salvage. It also addresses commitments regarding customer service beyond just those contained in the PDA. These features are merely illustrative, not comprehensive. The only matters the Agreement leave open are those relating to the calculation of rate case expense and a date upon which the Company is to file tariffs to implement the Commission's order.

VII. Conclusion

Liberty requests that the Commission issue an order approving the Agreement as a fair and reasonable resolution of this case based on the record that has been established in this case. In so doing, the Company further requests that the Commission order that rate case expense incurred by Liberty in this case be amortized over a period of three years and for such other orders and relief as may be appropriate and necessary to fully carry out the terms of the Agreement.

²⁰ It is important to point out that although the Commission may reject it in its entirety and decide all outstanding issues tried on August 16 individually, paragraph 14 of the Agreement makes it clear that it is an integrated whole wherein all of the individual items addressed are interdependent.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was sent via electronic mail on this 31st day of August, 2018, to:

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