

Exhibit No. _____
Issue: Company Background, Improvements,
Auditing and Tax Preparation Fees, Capital
Structure, Cost of Capital, Rate Case Expense
Witness: Josiah Cox
Type of Exhibit: Direct Testimony
Sponsoring Party: Indian Hills
Case No.: WR-2017-0259
Date: October 13, 2017

Missouri Public Service Commission

Direct Testimony

of

Josiah Cox

On Behalf of

Indian Hills Utility Operating Company, Inc.

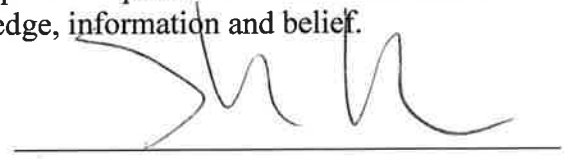
October 13, 2017

AFFIDAVIT

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

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

I, Josiah Cox, state that I am the President of Indian Hills Utility Operating Company, Inc. and, that the answers to the questions posed in the attached Direct Testimony are true to the best of my knowledge, information and belief.



Subscribed and sworn to before me this 13th day of October, 2017.



Notary Public

My Commission Expires: 01/31/2021



TABLE OF CONTENTS

| | |
|---|----|
| WITNESS INTRODUCTION..... | 1 |
| PARTIAL DISPOSITION..... | 8 |
| PURPOSE..... | 8 |
| INDIAN HILLS BACKGROUND..... | 9 |
| OWNERSHIP AND IMPROVEMENT OF ASSETS..... | 10 |
| EXISTING RATES..... | 21 |
| AUDITNG AND INCOME TAX PREPARATION FEES | 22 |
| CAPITAL STRUCTURE..... | 24 |
| RATE CASE EXPENSE | 28 |

**DIRECT TESTIMONY OF
JOSIAH COX
INDIAN HILLS UTILITY OPERATING COMPANY, INC.**

WITNESS INTRODUCTION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Josiah Cox. My business address is 500 Northwest Plaza Drive
Suite 500. St. Ann MO, 63074

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

A. I hold the office of President of Indian Hills and Central States Water Resources,
Inc.

**Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL
EXPERIENCE.**

A. I received a Bachelor of Science with a major in Environmental Science from the
University of Kansas. After graduation and a brief tenure at the Kansas
Biological Survey, I was employed by Fribis Engineering, a Civil Engineering
Firm in Arnold, MO. I spent approximately two and a half years working with
Fribis Engineering. I was involved during that time in various facets of the land
development process to include permitting, entitlement, civil design, project
management, and construction management. I focused mainly on the water and
wastewater side of the civil engineering business and participated in every part of
the civil business from wasteload allocation studies (now known as the anti-

1 degradation processes), design, permitting, project management, and
2 construction management. I also ran the environmental consulting division and
3 was the second private consultant to submit a water quality impact study in the
4 state of Missouri in 2003. At Fribis Engineering, I joined the executive leadership
5 team and helped run all of the operations of the firm. Thereafter, in 2005, I raised
6 money from a group of investors and formed Trumpet LLC. Trumpet LLC was a
7 full service civil engineering, environmental consulting, general contracting, and
8 construction management firm. In early 2006, I started the Executive Masters of
9 Business Administration (MBA) program at Washington University in St. Louis. I
10 graduated with my MBA from Washington University in the 2007. At Trumpet
11 LLC, as the Chief Operating Officer and finally Chief Executive Officer, I obtained
12 extensive experience with rural communities in every facet of the water and
13 wastewater compliance process including environmental assessment, permitting,
14 design, construction, operation and community administration of the actual water
15 and wastewater (sewerage) systems. At Trumpet, we performed stream
16 sampling and built waste-load allocation models to determine receiving water-
17 body protective permit-able effluent pollutant loads. We have done full
18 engineering design of multiple whole community wastewater and water
19 infrastructure systems including wells, water distribution, water treatment, water
20 storage, wastewater conveyance, and wastewater treatment plants and taken
21 these designs through federal and state administered permitting processes in
22 Missouri. Trumpet also administered the construction of these water and
23 wastewater systems from green field site selection all the way through system

1 startup and final engineering sign off. In 2008, I took over the operations on an
2 existing rural sewer district and I still currently operate a system actually
3 managing the functioning, testing, and maintenance of the system. Finally, I also
4 act as the administrator for this system performing all the billing, emergency
5 response, accounts payable / accounts receivable, collections, budgeting,
6 customer service, and public town meetings required to service the community.

7 **Q. PLEASE DESCRIBE YOUR POSITION AT CENTRAL STATES WATER**
8 **RESOURCES, INC.**

9 A. I have been the President of Central States Water Resources, Inc. (CSWR),
10 which manages First Round CSWR, LLC (First Round), for approximately three
11 and a half years. First Round, through its subsidiaries, has completed four
12 acquisition and financing cases with the Missouri Public Service Commission
13 (Commission) and two rate cases with the Commission.

14 **Q. WHAT IS THIS ORGANIZATION'S BUSINESS PLAN?**

15 A. The plan is to pursue the purchase and recapitalization of failing water and
16 wastewater utilities across the state of Missouri under the regulated utility small
17 rate case technical format. As an example of market size and future plans,
18 Central States estimates there to be 65 PSC regulated small sewer and/or water
19 companies in Missouri (Central States defines small sewer companies as sewer
20 companies servicing under 8,000 customers by firms that are not publically
21 traded). Out of those 65 small companies at least 7 are currently in state
22 appointed receivership and in the immediate danger of being closed down for
23 Missouri Department of Natural Resources (MDNR) regulatory reasons. The

1 average tariff rate (individual customer utility rate approved by the Commission)
2 in the remaining 58 systems has not been changed for approximately 10 years.
3 This means most of the Commission-regulated small sewer and/or water
4 companies in the state have not been in a rate case for over a decade. Based
5 on recent regulatory permit changes, Central States estimates at least 27 of the
6 entire 58 non-receivership regulated small sewer and/or water companies are
7 currently out of, or about to be out of, federal and state regulatory pollution or
8 dispense permit compliance. As the vast majority of permitted water and sewer
9 operations in the state are unregulated, these 32 targets (receiver and
10 regulatorily distressed) are just a small portion of the potential Central States
11 utility targets in Missouri.

12 **Q. WHAT IS FIRST ROUND'S EXPERIENCE WITH WASTEWATER/SEWER**
13 **SYSTEMS?**

14 A. On the wastewater side of the business, First Round has purchased five
15 wastewater treatment plants (WWTP) with associated sewer pumping stations,
16 gravity force mains, and gravity conveyance lines. The companies have
17 designed, permitted, and completed construction, with Missouri Department of
18 Natural Resources approval, of approximately \$2.4 million of sanitary sewer
19 systems since March of 2015. These improvements include wastewater line
20 repairs to remove infiltration and inflow, building sewer main extensions, the
21 repair of multiple lift stations, the construction of lift stations, the closure of an
22 existing regulatory impaired WWTP, building two fully activated sludge plants,
23 constructing two moving bed bio-reactor plants (MBBR), converting two failing

1 WWTP's into sludge storage/flow equalization and treatment basins, and
2 constructing various other wastewater supporting improvements. Central States
3 has also completed the design and construction permitting for major wastewater
4 improvements for the two wastewater systems, which are the subject of the
5 recently approved Elm Hills Utility Operating Company, Inc. acquisition case.
6 These designs include improvements to wastewater lines to remove infiltration
7 and inflow, building sewer main extensions, the repair of multiple lift stations,
8 building an internal nutrient removal reactor to an activated sludge plant,
9 constructing a moving bed bio-reactor plant (MBBR), converting one failing
10 WWTP's tankage into sludge storage/flow equalization and treatment basin, and
11 constructing various other wastewater supporting improvements.

12 **Q. WHAT IS FIRST ROUND'S EXPERIENCE WITH WATER SYSTEMS?**

13 A. On the drinking water side of the business, the companies have designed,
14 permitted, and has completed construction with Missouri Department of Natural
15 Resources approval of approximately \$2.6 million of drinking water systems
16 since March of 2015. These improvements include construction of three new
17 ground water storage tanks, construction of three sets of drinking water
18 pressurization pump assemblies, drilling a deep water well, erecting two new
19 well-houses, closing two failed well-houses, closing an exposed failed deep
20 water drinking well, rehabbing an existing impaired well-house, closing a failing
21 booster pump station house, replacement of over 700 meter pits with new
22 meters, replacement of numerous existing water service lines, installing
23 numerous isolation valve systems, installing multiple flush hydrants, repairing

1 almost hundreds of leaks and repairing or building various other supporting
2 drinking water system improvements. Central States has also completed the
3 design and construction permitting for another water improvement project
4 associated with the recently approved Elm Hills Utility Operating Company, Inc.
5 acquisition of the water assets of Missouri Utilities.

6 **Q. HAS YOUR ORGANIZATION BEEN ASKED BY THE COMMISSION STAFF**
7 **TO ASSIST WITH ANY OTHER SYSTEMS?**

8 A. Yes. In the spring of 2017, at the request of the Commission water and sewer
9 staff, we negotiated a purchase contract and immediate operations takeover of
10 Smithview H2O Company, a Commission-regulated drinking water system.

11 Thereafter, we were able to get Smithview off a MDNR mandated emergency boil
12 order. Since March of 2017, the organization has invested over \$59,000 in
13 disinfection system installation, emergency line repairs, emergency electrical
14 repairs, and operational services to keep Smithview operating and off a potential
15 MDNR mandated boil order.

16 **Q. HAS THE ORGANIZATION TAKEN STEPS TO IMPROVE SERVICES AT THE**
17 **SYSTEMS IT NOW OPERATES?**

18 A. Yes. In addition to the capital improvements made on all of the systems, the
19 organization has built from scratch customer service systems at each utility that
20 comply with the Commission's Chapter 13 rules and provide benefits to the
21 customers. This includes 24hr emergency service phone lines for potential
22 service issues, on-call emergency service contractor personnel, customer
23 dissemination of MDNR mandated drinking water testing information, on-line bill-

1 pay options, up-to-date website bulletins about current service status, and
2 service initiation or discontinuance procedures that are Commission compliant.

3 **Q. DOES CSWR/FIRST ROUND PLAN TO MAKE ADDITIONAL ACQUISITIONS?**

4 A. Yes. CSWR is in various phases of due-diligence on numerous other small,
5 failing water and wastewater utilities across the state of Missouri. Most recently,
6 as mentioned above, a CSWR managed utility, Elm Hills Utility Operating
7 Company, Inc. has Commission approval to purchase two wastewater systems,
8 and one water system (the water system and one sewer system (Missouri
9 Utilities Company) have been in Missouri state-appointed receivership for ten
10 years and has AG enforcement actions pending). This is a good example of the
11 type of systems CSWR is currently working on.

12
13 Another CSWR managed utility has contracts with approximately ten water and
14 wastewater systems, which contain four wastewater systems currently in state
15 appointed receivership, one water system in receivership (with an active attorney
16 general enforcement action), and two non-regulated wastewater systems in
17 attorney general enforcement actions. These transactions will be presented to
18 the Commission in the near future.

19

PARTIAL DISPOSITION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23

Q. HAS INDIAN HILLS BEEN ABLE TO REACH AGREEMENT IN REGARD TO ANY RATE CASE ISSUES?

A. A few. On September 1, 2017, the Staff of the Public Service Commission filed a Partial Disposition Agreement, which addressed many rate case issues.

Q. IS IT YOUR UNDERSTANDING THAT THE STAFF WILL FILE DIRECT TESTIMONY IN SUPPORT OF THAT PARTIAL DISPOSITION AGREEMENT?

A. Yes.

PURPOSE

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. I will first provide the Missouri Public Service Commission (Commission) with a description of Indian Hills and its operations. I will further describe the improvements that have been made to the water systems owned by Indian Hills. I will then provide testimony concerning certain issues that were not included in the agreement with the Staff. Those issues are as follows: (1) Repair Expense; (2) Auditing Expense; (3) Tax Preparation Expense; (4) Rate of Return; (5) Debt Cost; (6) Corporate Allocations, and (7) Capital Structure.

It is my understanding that the Office of the Public Counsel (Public Counsel) will identify additional issues it wishes to raise in this case. Indian Hills will address those issues in its rebuttal testimony.

Q. WHICH OF THE ABOVE ISSUES WILL YOU ADDRESS?

A. Auditing Expense, Tax Preparation Expense, and Capital Structure.

1

2 **Q. WHO WILL ADDRESS THE OTHER ISSUES?**

3 A. Dylan D'Ascendis will address Rate of Return; Mike Thamon will address Debt
4 Costs; Todd Thomas will address Maintenance Expense and the Payroll
5 Component of Corporate Allocations; and, Phil Macias will address Repair
6 Expense, Auditing Expense, Tax Preparation Expense, and Corporate
7 Allocations

8

9

INDIAN HILLS BACKGROUND

10 **Q. PLEASE DESCRIBE INDIAN HILLS.**

11 A. Indian Hills provides water service to approximately 715 residential customers
12 through a booster pump station energized water system serviced by two wells,
13 two ground water storage tanks and a distribution system located near Cuba,
14 Missouri.

15 **Q. IS INDIAN HILLS A PART OF A LARGER ORGANIZATION?**

16 A. Yes. As discussed above, First Round CSWR, LLC is Indian Hills' ultimate
17 parent company. Central States Water Resources, Inc. is the manager for First
18 Round CSWR, LLC. I commonly refer to the entire business organization as a
19 whole by the name "Central States" or "CSWR."

20 **Q. DOES INDIAN HILLS HAVE ANY OF ITS OWN EMPLOYEES?**

21 A. No.

22 **Q. HOW DOES IT PROVIDE SERVICE?**

1 A. Indian Hills hired a local third-party Operations and Maintenance (O&M) firm that
2 carries the mandatory MDNR licenses and appropriate insurance to manage the
3 daily water operations. The O&M firm has a 24-hour emergency service line for
4 service disruption services that forwards all service issues to myself as president
5 of Central States and Todd Thomas as senior vice president of Central States.
6 Indian Hills also hired a billing and customer service firm to send out bills and
7 handle customer service related to billing questions. Moreover, Indian Hills has
8 setup an online billing system to receive credit card and e-checks and customer
9 service email accounts specific to Indian Hills to field on-going customer
10 interactions.

11 All of the management, financial reporting, underground utility safety and location
12 services, Commission regulatory reporting, MDNR regulatory reporting,
13 environmental management, operations oversight, utility asset planning,
14 engineering planning, on-going utility maintenance, total utility record keeping,
15 and final customer dispute management is done out of the corporate office with
16 proportional costs passed down to Indian Hills.

17

18 **OWNERSHIP AND IMPROVEMENT OF SYSTEMS**

19 **Q. HOW DID INDIAN HILLS ACQUIRE ITS WATER SYSTEM?**

20 A. Indian Hills acquired its water system from I.H. Utilities, Inc., which was a public
21 utility regulated by the Commission. The Commission provided approval of this
22 transaction in its File No. WO-2016-0045.

1 **Q. WHAT APPROVAL DID INDIAN HILLS SEEK FROM THE COMMISSION IN**
2 **FILE NO. WO-2016-0045?**

3 A. Indian Hills sought the Commission's permission to acquire the water assets of
4 I.H. Utilities, Inc., and to issue indebtedness and to encumber those acquired
5 assets in order to fund the construction necessary to bring the system into
6 regulatory compliance. Indian Hills's proposed financing was examined by the
7 participants in that case. Ultimately, a Stipulation was reached and the
8 Commission approved the transactions, with conditions, by its Order Regarding
9 Stipulation and Agreement and Certificate of Convenience and Necessity issued
10 February 3, 2016, effective March 4, 2016.

11 **Q. ON WHAT DATE DID INDIAN HILLS CLOSE ON THESE TRANSACTIONS?**

12 A. The transfer that was the subject of Case No. WO-2016-0045, was completed on
13 March 31, 2016.

14 **Q. WHAT WAS THE CONDITION OF THE I.H. UTILITIES, INC. WATER SYSTEM**
15 **WHEN IT WAS ACQUIRED BY INDIAN HILLS?**

16 A. The original Indian Hills drinking water system was constructed approximately
17 fifty years ago. Indian Hills does not believe any major capital improvements
18 were completed after the initial construction was completed. The original system
19 was in a state of significant disrepair that centered around six major enforcement
20 issues or schedules of compliance associated with the system's existing
21 operation at the time Indian Hills bought the water assets.

22 **Q. WHAT WAS THE FIRST ISSUE?**

1 A. The first issue was that I.H. Utilities had only one well in service. For drinking
2 water systems serving over fifty homes, MDNR's design guides require two
3 drinking water wells. I.H. Utilities lost the ability to run one of its drinking water
4 wells sometime in the past and was functioning with only one well. The existing
5 well house posed a major safety hazard with exposed electrical wiring with
6 leaking indoor piping, a building that had been subject to fire damage from a
7 lightning strike, and existing buried water tanks that had been significantly
8 corroded over time. The second nonfunctioning well was housed in a dilapidated
9 shack with mold, lack of lighting, and a lack of basic system security.

10 **Q. WHAT WAS THE SECOND ISSUE?**

11 A. The second major set of issues related to system reliability. At the time of
12 acquisition, there was no backup power or backup pumping system, nor was
13 there adequate on-site drinking water storage. The existing storage tank was
14 less than 20,000 gallons, and it was partially buried and badly corroded. In
15 emergency situations the system would run out of water due to a lack of
16 pressure. This system was out of compliance for water emergency service
17 reliability.

18 **Q. WHAT WAS THE THIRD ISSUE?**

19 A. The third major issue was water loss inside the system. MDNR drinking water
20 guides state that water loss inside a drinking water conveyance system should
21 not exceed ten percent of total water extracted from wells. I.H. Utilities was
22 losing about 75% of all the water pumped to leakage from the existing water
23 conveyance lines. This water loss was associated with a water main conveyance

1 system that is made out of piping that is half the thickness required by the
2 National Science Foundation (NSF) for drinking water applications, piping that
3 varies in size, without design logic, from 3-inch pipe to - inch pipe across the
4 entire 16+ miles of distribution system. The original connection piping from the
5 water mains to the water meters and from the meters to the houses consists of
6 plastic roll piping commonly used in lawn irrigation (a non-NSF approved
7 application for drinking water). Below is a picture showing the existing
8 connection piping with multiple hose clamps that partially illustrates part of the
9 reason why the I.H. water loss was so high.



10

11

12 **Q. WHAT WAS THE FOURTH ISSUE?**

1 A. The fourth major issue was system water pressure. MDNR current design
2 guides require a minimum of 21 psi of water pressure, with a guideline of 35 psi
3 for residential drinking water systems. The minimum of 21 psi is critical as that
4 energizes water lines to prevent outside contaminants entering water lines and
5 endangering human health. That is why a boil order is required when pressure
6 falls below this level. During peak usage times at the Indian Hills Lake,
7 customers on the back side of the lake would not have any water pressure,
8 violating minimum MDNR standards, and endangering residents' health. At the
9 time of acquisition, Indian Hills registered a maximum of 20 psi at the back of the
10 lake community and, as stated previously, during peak usage no water pressure
11 at all. This suggests the I.H. system should have been on a MDNR mandated
12 boil water order for some time.

13 **Q. WHAT WAS THE FIFTH ISSUE?**

14 A. The fifth major issue concerned the booster pumps. Water systems utilize
15 booster pumps for system pressure. MDNR requires redundant pumps at every
16 booster station to ensure system reliability. The original tank and booster station
17 only had one pump, putting the entire system at risk for total system failure.

18 **Q. WHAT WAS THE SIXTH ISSUE?**

19 A. The sixth major issue concerned the MDNR requirement for nominal storage
20 equal to or greater than one day's average usage. Indian Hills fluctuates from
21 80,000 gallons per day in the winter period to just over 270,000 gallons per day
22 in the summer and around holidays. Average usage for the year is around
23 125,000 gallons per day, while in the summer months it averages around

1 180,000 gallons. MDNR typically states that they will not approve a storage tank
2 that does not provide at least 1.5 times the average daily flow. With that being
3 said, MDNR required using the summer peak months of July through September
4 which averages just under 180,000 gallons. This equates to 270,000 gallons
5 after the 1.5 multiplier required by MDNR. At the time of acquisition, I.H. had a
6 tank with less than 20,000 gallons of storage, or only four hours of water service
7 during peak summer season usage.

8 **Q. WAS INDIAN HILLS' SYSTEM OUT OF COMPLIANCE WITH MDNR IN**
9 **REGARD TO THE WATER SYSTEM?**

10 A. Yes. Indian Hills had a list of twenty-seven (27) MDNR compliance issues:

11 1-The public water system failed to conduct daily monitoring of chlorine residual
12 levels within the public water system's distribution system. Daily testing of
13 chlorine residuals within the public water system's distribution system insures
14 that chlorine levels are maintained to eliminate contaminants within the water
15 system;

16 2-The public water system did not have a stand-by chief operator to operate and
17 maintain the drinking water system in the event that the chief operator is
18 unavailable or incapacitated;

19 3-The public water system did not have an up-to-date coliform site sample plan in
20 accordance with Missouri Public Drinking Water Commission;

21 4-The public water system did not develop a Disinfection by-product (DBP)
22 monitoring plan in accordance with Missouri Public Drinking Water Commission;

23 5- The public water system did not have a lead ban user's agreement;

- 1 6- The public water system was in violation of Missouri Safe Drinking
- 2 Commission Regulation 10 CSR 60-9.010 which establishes requirements for
- 3 maintaining public water system records;
- 4 7-Lack of a backup well and emergency power;
- 5 8-The master meter for Well # 1 was not being read;
- 6 9-A sample tap was not provided for collecting samples at the well prior to any
- 7 chemical treatment for Well #1;
- 8 10-The well's drawdown gauge was not being utilized to measure for static water
- 9 level(s) and pumping water level;
- 10 11-Corrosion was observed on the surface of the well casing, wellhead and
- 11 piping;
- 12 12- Poor housekeeping was observed in the well houses at both wells;
- 13 13-The public water system did not have a cross-connection control plan in
- 14 accordance with Missouri Public Drinking Water Commission regulation 10 CSR
- 15 60-11_Q10;
- 16 14-Low pressure inside the system;
- 17 15-The public water system did not have an up-to-date distribution map;
- 18 16- The public water system did not have a program for not did it practice routine
- 19 unidirectional water main flushing;
- 20 17- The public water system did not have sufficient water storage for the current
- 21 population;
- 22 18-The public water system did not have the most recent water storage facility's
- 23 inspection and/or repairs reports and the public water system did not have any

1 records of the 5,000-gallon pressure tank ever being inspected by a professional
2 tank inspector;

3 19-The water storage facilities were only partially housed. The back 90% of the
4 water storage facilities were buried and not protected by a building;

5 20- Corrosion was observed on the surface of the water storage facilities exterior
6 surfaces and related components housed within the well house;

7 21- The public water system had only one (1) chemical feeder and a repair kit for
8 this feeder. Standby or redundant disinfection facilities were not provided;

9 22- The ventilation piping for the chlorine solution tank was not screened.

10 23-There was no emergency notification system for the failure of a critical
11 pressure booster pump(s);

12 24-The public water system has only one (1) booster pump available at each
13 well/storage facility for pressure regulation;

14 25- There was no lighting within the pump house for safety or for routine
15 inspection and maintenance at the Highway DD Booster Pump Station;

16 26-There was no heating or adequate ventilation for the original Highway D
17 Booster Pump Station; and,

18 27-The building walls for the pump house at Highway DD Booster Pump Station
19 were rotting and falling down.

20

21 **Q. WAS INDIAN HILLS REQUIRED TO MAKE CERTAIN IMPROVEMENTS**
22 **WHEN IT ACQUIRED THE SYSTEM?**

1 A. Yes. Attached as Schedule JC-01 is the MDNR inspection letter for the IH
2 Utilities system.

3 **Q. WAS THE NECESSITY OF THE IMPROVEMENTS TO THE WATER SYSTEM**
4 **KNOWN AT THE TIME INDIAN HILLS RECEIVED APPROVAL OF THE**
5 **TRANSACTION IN FILE NO. WO-2016-0045?**

6 A. Yes. The Application, as well as other documents in that matter, described the
7 issues, the planned improvements, and the cost of those improvements. Indian
8 Hills provided the Commission Staff with copies of MDNR inspection letters,
9 engineering estimates and technology selections associated with the required
10 improvements. Additionally, in the acquisition case, Indian Hills proposed a
11 financing plan/transaction related to the improvements that was approved by the
12 Commission.

13 **Q. DID INDIAN HILLS MOVE FORWARD WITH IMPROVEMENTS TO THE**
14 **INDIAN HILLS SYSTEM?**

15 A. Yes. Indian Hills began construction on the wastewater improvements
16 approximately 30 days after it acquired systems.

17 **Q. WHAT IMPROVEMENTS WERE MADE TO THE SYSTEM?**

18 A. The following improvements and construction were completed:
19 - The existing well one house had to be demolished. An entire new well house
20 was built. The new well house had a separate room for disinfection
21 equipment in order to protect equipment from corrosion.

- 1 - The existing deep water well was converted into a pitless well in a yard to
2 allow for direct work via heavy equipment in emergency situations. This pit-
3 less well is properly sealed and protected.
- 4 - Piping was run from the well through the main well house where a magnetic
5 meter and testing tap were installed to meet MDNR requirements for well
6 production measurement and direct well water testing.
- 7 - The piping was then run through the sperate disinfection room which has
8 properly constructed ventilation where chlorine is added. The chlorine is
9 added via chlorine pumps with redundant pumping to meet MDNR
10 requirements for emergency service.
- 11 - The piping then feeds the new 270,000 ground storage tank which allows for
12 mandatory chlorine contact time of the water post disinfection.
- 13 - The new piping then runs from the ground storage tank back into the main
14 building where a chlorine analyzer maintains constant reading to ensure
15 MDNR required residual disinfection is maintained in the drinking water.
- 16 - The water is then fed through dual (required by MDNR for system stability)
17 variable frequency drive booster stations and forced into the water distribution
18 system to maintain pressure.
- 19 - A backup generator was installed behind the building on a concrete structure
20 to provide emergency power per MDNR requirement for system stability.
- 21 - Remote monitoring equipment feeds information on the well production,
22 chlorine addition, chlorine residuals, amount of water pumped into the
23 system, and status of the backup generator.

- 1 - The old non-functioning well was plugged to MDNR standards, and a new
2 well drilled on the west side of the lake.
- 3 - Since the existing water distribution system is made up of random,
4 substandard, variable pipe sizes running from 3 inches to 6 inches it was not
5 possible to ensure minimum MDNR water pressure due to friction loss across
6 the distribution system via one booster station. In addition, a single booster
7 station and ground storage tank could not provide drinking water volumes
8 during peak lake water use in the summer. To meet these requirements, a
9 new approximately 500-foot deep water well was drilled to meet MDNR
10 requirements for source redundancy. This well was built in a pit-less
11 configuration as well.
- 12 - A well house servicing the new well was constructed almost exactly like Well
13 # 1. Piping was run from well two through the main well house where a
14 magnetic meter and testing tap were installed. The piping then runs through
15 the sperate disinfection room which has properly constructed ventilation
16 where chlorine is added. The chlorine is added via chlorine pumps with
17 redundant pumping. The piping then feeds a new 50,000 ground storage
18 tank which allows for mandatory chlorine contact time of the water post
19 disinfection and peak water storage. New piping then runs from the ground
20 storage tank back into the main building where a chlorine analyzer maintains
21 constant reading to ensure residual disinfection is maintained in the drinking
22 water. The water is then feed through dual variable frequency drive booster
23 stations and forced into the water distribution system to maintain pressure to

1 the back side of the lake. Remote monitoring equipment feeds information on
2 the well production, chlorine addition, chlorine residuals, amount of water
3 pumped into the system.

- 4 - After closing on the system, it was determined that the previous owner had
5 not done meter reading for years. The original meter pits were made of
6 compressed cardboard and were disintegrating in the ground and the meters
7 had failed. Every house and lot (725) had new drinking water grade HDPE
8 meter pits and new remote electronic meters installed. In addition to the on-
9 going repairs of lines, approximately 50 water taps have been replaced.

10 **Q. WHEN WERE THESE IMPROVEMENTS COMPLETED?**

11 A. The improvements were completed by February of 2017.

12 **Q. DID THE MISSOURI DEPARTMENT OF NATURAL RESOURCES INSPECT
13 AND ACCEPT THE IMPROVEMENTS?**

14 A. Yes. The major improvements were inspected and accepted by MDNR in 2016.
15 A copy of the acceptance letter is attached hereto as Schedule JC-02.

16 **Q. WHAT WAS INDIAN HILLS' INVESTMENT IN THE NEW FACILITIES?**

17 A. Indian Hills has invested approximately \$1.84MM in the facilities.
18

19 **EXISTING RATES**

20 **Q. WHAT ARE THE EXISTING RATES FOR THE SYSTEMS AND WHEN WERE
21 THESE RATES ESTABLISHED?**

22 A. The current rates are as follows:

- 23 - A \$10.81 base rate, which includes 4,000 gallons of use; and,

1 - a volumetric rate of \$1.89 for every 1,000 gallons used over the original 4,000
2 gallons. These rates became effective October 27, 2009.

3 **Q. HOW WAS THIS RATE CASE INITIATED?**

4 A. Indian Hills initiated this small company rate case by its letter to the
5 Commission dated March 31, 2017.

6 **Q. WILL THE RATES REQUESTED BY THE COMPANY RESULT IN A
7 SUBSTANTIAL INCREASE FOR THE INDIAN HILLS CUSTOMERS?**

8 A. Yes, they will. The water system required a substantial rebuild (which is
9 still underway, to some extent) to: (1) to be operational for the provision of
10 service to the customers; and, (2) to comply with federal and state
11 regulations related to those services.

12
13 **AUDITING AND INCOME TAX PREPARATION FEES**

14 **Q. WHAT DISAGREEMENT DOES INDIAN HILLS HAVE WITH THE
15 COMMISSION STAFF IN REGARD TO AUDITING AND TAX PREPARATION
16 FEES?**

17 A. The Staff has not included the direct audit and tax preparation fees for Indian
18 Hills, or Indian Hills' pro-rata share of tax and audit fees from Central States.

19 **Q. ARE THESE AMOUNTS THAT ARE CURRENTLY BEING PAID?**

20 A. Yes, they have been paid. Attached hereto as **Schedule JC-03 Confidential**
21 are the final invoices for tax and audit fees associated with Indian Hills and First
22 Round CSWR, LLC.

1 **Q. DID THE COMPANY TAKE ANY STEPS TO MINIMIZE ITS AUDITING AND**
2 **TAX PREPARATION FEES?**

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

6 **Q. WHAT WAS THE LOWEST COST FOR THESE SERVICES INDIAN HILLS**
7 **FOUND THROUGH THE RFP PROCESS?**

8 A. The lowest price was provided by Mueller Prost.

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

10 A. \$21,628.58 which is Indian Hill's direct costs of \$14,000 (\$10,000, financial audit
11 and \$4,000, tax preparation) added to an 18% allocation of CSWR's audit and
12 tax fees of \$20,158.76, 18% of which is \$3,628.58.

13 **Q. WHY IS IT NECESSARY FOR INDIAN HILLS AND ITS PARENT TO HIRE AN**
14 **OUTSIDE ACCOUNTANT OR FIRM TO PERFORM THESE SERVICES?**

15 A. One of the major problems facing failing water and sewer companies is a lack of
16 professional management and attention to regulatory and statutory compliance.
17 The former owner of these systems did not correctly file tax forms (resulting in
18 federal tax liens at the time of acquisition), nor did they develop and maintain
19 accurate financial records. Further, every major government funding source for
20 water and wastewater improvements (and in some cases, private funding
21 sources) require audited financials. These government funding groups include
22 USDA Rural Development, The Missouri Clean Water State Revolving Fund, and
23 Missouri Community Development Block Grants. In addition, CSWR has had

1 recent experience where it was denied equipment financing due to a lack of
2 audited financials for the target utility. Tax preparation and audit fees are a
3 normal course of business for a professionally managed utility. This is
4 particularly important for a utility, or group of utilities, that is actively engaged in
5 attempting to raise capital.

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

7 A. The Commission should order that Indian Hills's share of the actual audit and tax
8 preparation fees be included in its revenue requirement.

9
10 **CAPITAL STRUCTURE**

11 **Q. WHAT DISAGREEMENT DOES INDIAN HILLS HAVE WITH THE**
12 **COMMISSION STAFF IN REGARD TO CAPITAL STRUCTURE?**

13 A. Instead of using Indian Hills's actual capital structure, Staff has recommended a
14 hypothetical capital structure with a higher equity ratio than is actually being used
15 by Indian Hills.

16 **Q. WHAT IS THE APPROPRIATE TREATMENT OF THE ISSUE?**

17 A. The Commission should use Indian Hills's actual capital structure.

18 **Q. WHY SHOULD THIS BE IMPORTANT TO THE COMMISSION?**

19 A. Central States estimates that almost 50% of the existing regulated small water
20 and/or sewer companies in Missouri are under some type of compliance or
21 regulatory order. Central States has intervened in two regulated water systems,
22 Hillcrest Utility Operating Company, Inc., and now Smithview H2O Company, that
23 were in the midst of boil orders. The Indian Hills Lake Subdivision water system

1 now before the Commission was only kept out of MDNR major enforcement
2 actions as a result of Central States' acquisition and commitment to make the
3 necessary improvements to bring the water system back into regulatory
4 compliance. I have come across both regulated and un-regulated community
5 utilities across the State that are violating minimum MDNR health and safety
6 standards, creating health risks for residents. In addition to individual health
7 risks, these failing systems are degrading the water quality and environmental
8 stability of the state's rivers and streams.

9 **Q. HOW DOES THIS SITUATION RELATE TO THE APPROPRIATE CAPITAL**
10 **STRUCTURE?**

11 A. For a utility to invest in basic water and wastewater infrastructure, the regulatory
12 environment must recognize the limited practical options that are available.
13 Actual market conditions dictate what investment criteria are needed to obtain
14 the capital investment necessary to make MDNR-mandated improvements
15 required to bring failing systems back to health, safety, stability, and
16 environmental compliance. Small, failing water and wastewater utilities represent
17 a unique situation.

18 **Q. HOW DOES THIS APPLY TO THE INDIAN HILLS SYSTEM?**

19 A. For perspective, Staff determined that Indian Hills had a net book value of
20 \$43,966 at the time of Indian Hills's acquisition case. Indian Hills' net book value
21 versus required MDNR investment dollars represented a 2.5% equity basis. That
22 net book value did not take into account the existing tax liens against I.H. Utilities
23 prior to closing. If the existing tax liens were counted against the utility assets,

1 the net book value would be \$609, or 0.03%, on an equity basis versus the
2 improvements required. The annual reports filed by the previous company
3 suggest that it had an Earnings Before Interest, Tax, and Amortization of less
4 than \$32,000 annually. The utility represented a significant commercial liability
5 with existing tax liens, MDNR compliance issues, on-going and past drinking
6 water violations, and an actual public health risk (a lack of minimum system
7 pressure and corresponding boil water notice allowing residents to be potentially
8 exposed to drinking water contaminants). In order to meet minimum MDNR
9 environmental requirements Indian Hills had to invest approximately \$1.84 million
10 in a very short time frame -- something that would be required of any entity that
11 attempted to bring these systems into compliance.

12 **Q. DOES REGULATORY LAG ALSO MAKE THIS PROCESS MORE DIFFICULT**
13 **WHERE A UTILITY HAS NOT HAD NEW RATES SET FOR SOME TIME?**

14 A. Yes. The impact of regulatory lag further makes recognition of Indian Hills'
15 capital actual structure important. For example, Indian Hills began construction
16 on the improvements that are the subject of this case in April of 2016, shortly
17 after it acquired the system. During the time of construction, the direct costs of
18 operating the Indian Hills systems has resulted in a cash loss outside of any
19 overhead allocations of \$371,611.66 since 2016. These costs include repair and
20 maintenance of failing water mains and taps, certified operators, customer
21 service and billing, increased power costs, and increased chemical costs.

22 **Q. IS THIS UNUSUAL FOR A SMALL UTILITY IN THIS CONDITION?**

1 A. No. I estimate, based on experience and statutory guidelines, that small,
2 distressed utilities take 3-4 four months of engineering and permitting with
3 MDNR, and 5-6 months of construction. The small rate case format has a target
4 of 11 months from filing to new rates, and a strong preference for actual
5 experience during at least part of an historic test year. This means that from
6 initial expenditures on engineering for MDNR permitting, through construction,
7 then through a rate case, a small distressed water and sewer company can
8 expect to lose money on professional operations and pay for major capital
9 improvements (in Indian Hills's case capital costs are over 40x of existing net
10 book value) for 17-21 months before any cash flow stabilization (new rates). The
11 regulatory lag associated with Indian Hills' 3rd party outside professional certified
12 drinking water operations, critical equipment maintenance, and drinking water
13 infrastructure repairs by the end of September 2017 is 8.5x the rate base of
14 Indian Hills at the time of acquisition. If corporate allocations were also applied,
15 this loss would be even higher.

16 **Q. WHAT IS INDIAN HILLS' ACTUAL CAPITAL STRUCTURE?**

17 A. The Staff and Company stipulation states that the net book value (NBV) of Indian
18 Hills is \$1,837,997 outside of AFUDC. Of this NBV, \$1,450,000 represents
19 principal on long term debt. Outside of AFUDC, Indian Hills Capital Structure is
20 21.2% Equity, and 78.8% Debt.

21 **Q. DO THESE CIRCUMSTANCES, THE SIGNIFICANCE OF THE INVESTMENT,**
22 **AND THE TIME FRAME GIVE AN ACQUIRING COMPANY MANY OPTIONS**
23 **IN TERMS OF HOW IT ACCESSES CAPITAL?**

1 A. No. The capital structure Indian Hills is utilizing is the only structure that could be
2 found. Moreover, this is the same structure Indian Hills presented to Commission
3 in its acquisition and financing application.

4 **Q. IN YOUR OPINION, WHAT IS NECESSARY FOR INVESTORS TO CONTINUE**
5 **TO PARTICPATE IN THIS PROCESS?**

6 A. Any potential investor has to have confidence that the actual capital structure
7 required to fix failing water and sewer utilities will be recognized for rate making
8 purposes. This is especially true for systems that are out of regulatory
9 compliance and carrying higher commercial liability risks with lower equity bases.

10 **Q. DOES THE CAPITAL STRUCTURE HAVE AN IMPACT ON ANY OTHER**
11 **ISSUES?**

12 A. Yes. AFUDC should be calculated based on the actual loan terms, amounts
13 borrowed, and corresponding capital structure associated with the money
14 borrowed by the Company.

15

16 **RATE CASE EXPENSE**

17 **Q. DOES INDIAN HILLS HAVE EXPENSES RELATED DIRECTLY TO THE**
18 **PROCESSING OF THIS RATE CASE?**

19 A. Yes. Indian Hills has expenses, such as those related to the individual customer
20 notices it provides. It also has incurred attorney and expert witness fees
21 associated with the processing of this case. Indian Hills will provide Staff and
22 OPC with copies of the invoices associated with this case that have been

1 received thus far. Indian Hills will continue to provide those invoices as they are
2 received in the future.

3 **Q. DOES INDIAN HILLS KNOW WHAT THOSE EXPENSES WILL BE?**

4 A. Not at this time, as the case is far from complete.

5 **Q. WHAT DO YOU PROPOSE IN REGARD TO RATE CASE EXPENSES?**

6 A. The Company is incurring rate case expense in order to bring the matters in
7 dispute before the Commission. These expenses are reasonable. Accordingly,
8 an allowance for rate case expense (normalized over three years) should be
9 included in the revenue requirement in this proceeding that includes invoices of
10 Indian Hills's attorney and expenses related to the rate case (such as those
11 associated with customer notices). The Commission should bring these
12 expenses forward to a date that will allow the majority of costs to be captured in
13 the Commission's order, such as a cut-off date of at least one week after the
14 filing of post-hearing briefs.

15 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

16 A. Yes, it does.