

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

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| In the Matter of Lake Region Water & Sewer   | ) | File No. SR-2010-0110   |
| Company's Application to Implement a General | ) | Tariff No. YS-2010-0250 |
| Rate Increase in Water & Sewer Service       | ) |                         |

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| In the Matter of Lake Region Water & Sewer   | ) | File No. WR-2010-0111   |
| Company's Application to Implement a General | ) | Tariff No. YW-2010-0251 |
| Rate Increase in Water & Sewer Service       | ) |                         |

**LAKE REGION WATER & SEWER CO.'S  
RESPONSE TO STAFF'S JUNE 7, 2010 REPLY TO LAKE REGION'S  
RESPONSE TO MAY 19, 2010 ORDER OF THE COMMISSION**

Comes now Lake Region Water & Sewer Co. (Lake Region or Company) and submits the following to the Commission:

1. On May 26, 2010, Lake Region responded to revenue scenarios submitted by the Commission's Staff pursuant to an earlier order of the Commission.
2. On May 27, 2010, the Commission directed the Staff to file a reply to Lake Region's May 26, 2010 response (Lake Region's Response). On June 7, 2010, the Staff filed its reply (Staff's Reply).
3. Lake Region submits what follows in answer to several portions of Staff's Reply.

**Page 1, Paragraph 5.**

4. In Paragraph 5 of Staff's Reply, Staff asserts that it "did not use an amount of debt different than what the parties stipulated to calculate the three scenarios presented in its May 18, 2010 filing." Lake Region has never claimed Staff did. The point of Lake Region's Response was that Staff used the same capital structure as the one presented in Staff's direct case on January 14, 2010 (as Staff goes on to concede in Paragraph 5). A company cannot fund a \$7,000,000 rate base with a \$3,000,000 capital structure. Lake Region made the appropriate

adjustment to the capital structure to match the rate base under the new scenario. Staff did not match the capital structure to the rate base in its May 18 filing. Lake Region's Response assumed the additional rate base was funded through equity since the parties had stipulated a debt number. Lake Region provided Schedule 2 to show the revenue requirement assuming the additional rate base was funded through debt at the same interest rate as stipulated in the original capital structure.

5. During review of Staff's Reply, Lake Region discovered a formula error in the Rate of Return calculation in Lake Region's Response. The error caused the revenue requirement to be overstated. With this error corrected and using Staff's uncollectible factor, the Company's adjusted total revenue requirement for this scenario is \$510,056 versus Staff's \$512,303. The difference is probably attributable to the Exhibit Modeling System utilized by Staff. However, Lake Region accepts Staff's number as the correct one to use for this scenario.

**Page 2, Paragraph 6.**

6. In Paragraph 6 of Staff's Reply, Staff claims that "the Company continues to represent to the Commission that while availability fees were included as revenues in Case No. WR-99-183 [an Ozark Shores Water Company rate case] contributed plant was added back to the rate base." Staff's claim is not supported in the record and is made in error. **Lake Region has not represented at any time that contributed plant was added back to rate base in any Ozark Shores Water Company case.** Lake Region's witnesses have testified that Staff has always included both the availability fee revenue and associated plant or excluded both the availability fee revenue and associated plant. As discussed later in this document the historical record of Commission cases confirms the testimony of Lake Region's witnesses.

7. In Case No. WR-92-59<sup>1</sup> the Staff excluded the availability fees from revenue and made adjustments to reduce plant, which had not previously been treated as contributed, in order to match revenue to rate base. In Case No. WR-99-183, Staff included availability fees as revenue in the case but Staff also did not make the reductions in plant it made in Case No. WR-92-59, hence the plant balance was not reduced. If the Commission decides to include availability fee revenues in the current case, then in keeping with its treatment of availability fees in previous rate cases,<sup>2</sup> the Commission may properly reclassify the associated plant from contributed plant to invested plant.

8. Staff's use of only one of the Ozark Shores' cases for comparison provides an incomplete and misleading picture. Moreover, the major difference between Ozark Shores and Lake Region, and one that cannot be over-emphasized, is that Ozark Shores actually owns the rights to the availability fees, and Lake Region does not.

**Page 3, Paragraph 7.**

9. In Paragraph 7 of Staff's Reply, Staff states in effect that Lake Region has not provided any evidence that availability fees were not created "to help pay for the costs to support the utility infrastructure such as repairs, maintenance, construction of new plant to replace old infrastructure and support the general operations of the utility to enable it to provide utility service to its customers." Staff believes availability fees *were* created for that purpose. Putting aside for the moment any arguments relating to Lake Region's lawful burden of proof in this case, it is equally apparent that Staff has not supplied any evidence that availability fees "were created by the original developer" in accord with Staff's belief. An entity not a party to this case

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<sup>1</sup> This case is not referenced in Staff's Reply. The Commission will recall that copies of the Report and Order and related work papers in Case No. WR-92-59 were attached collectively as Schedule 3 to Lake Region's response to the May 19, 2010 Order.

<sup>2</sup> The Commission's (and Staff's) treatment of availability fees in the manner testified to by Lake Region's witnesses can be traced to Case No. 17,954 which is discussed *infra*.

has filled the evidentiary void, however. The Commission's recently issued subpoena to the real estate developer produced an affidavit in which this statement appears: **"The purpose of the availability fees was to recover the investment in the water and sewer systems, not to subsidize the operations of the systems."**<sup>3</sup> The developer's testimony clearly supports the position maintained by the Company throughout this case. As Lake Region discusses in subsequent sections of this response, its position has been shared by the Commission in all previous cases.

#### **Pages 5 - 6, Paragraph 11**

10. In Paragraph 11, Staff appears to offer excuses for not accurately depicting Lake Region's capital structure in its initial response to the Commission's April 8 order. If they are excuses they should be given no weight. The Commission ordered Staff to create the new scenario. Also in this paragraph of its reply, Staff recommends that the Commission adopt its "original capital structure and rate of return filed in Staff's Cost of Service Report on January 14, 2010 *and agreed to by the parties in this case.*" [emphasis added] Staff has apparently changed its mind regarding this recommendation. In *Staff's Late Filed Exhibit* filed on June 21, 2010 it has *changed the rate of return* agreed to by the parties in this case.<sup>4</sup> Staff's latest filing proposes a capital structure of 104% debt and zero equity. Company is not aware of any case approved by this Commission in which a company was allowed to over-leverage to this extent. Lake Region was content with rate of return from the capital structure set out in Staff's Cost of Service Report on January 14, 2010 but that capital structure did not include any entries for availability fees.

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<sup>3</sup> See paragraph 3 of the *Affidavit of Peter N. Brown*, filed May 17, 2010.

<sup>4</sup> The Commission ordered Staff to file a late filed exhibit outlining its most current recommendations for rate base and the specific dollar amount it recommends the Commission consider for additions to plant for True-Up. What Staff has filed exceeds the scope of the order and unnecessarily injects a new issue into the case.

Staff did not inject the issue of availability fees into this case until after it had filed its direct case.

11. Staff claims that it used its approach in arriving at its capital structure for the Company due to a lack of information. As the reasons for the lack of information it cites Lake Region's objections to Staff Data Request Nos. 0062 and 0063. The data requests asked for financial information in the possession of RPS Properties L.P. which is not a party to this matter. The objections were not overruled. Additionally, Staff is aware that the capital structure of the Company must fund every dollar of rate base. This is a fundamental ratemaking tenet. The proper capital structure to be used in this rate case is the capital structure on Lake Region's books, and has nothing to do with a shareholder's value of investment.<sup>5</sup>

12. On page 6 of Staff's Reply, continuing in Paragraph 11, Staff reports the results of Scenario 1. Scenario 1 is the only scenario responsive to the Commission's Order and the Rate of Return shown on Staff's Schedule 1 is comparable to that arrived at by Company. As noted in Paragraph 5 above, the revenue requirement for this scenario contained in the table on Page 14 of Staff's Reply is also comparable to Lake Region's adjusted revenue requirement for this scenario.

#### **Pages 6-7, Paragraph 12**

13. In this paragraph Staff refuses to acknowledge that by valid assignments and other agreements title to the availability fees charged to undeveloped lot owners on Shawnee Bend is vested in Sally Stump and RPS Properties L.P. Staff relies on provisions of the covenants and

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<sup>5</sup> Lake Region decided not to oppose the capital structure Staff filed in its Cost of Service Report of January 14, 2010 but given the Staff's Late Filed Exhibit and its changes, capital structure is now an issue in this case. Per the Company's books, the proper capital structure in this case would be 100% equity which is accurate since even the debt used in Staff's capital structure is in the name of the shareholders and 100% personally guaranteed by the shareholders.

restrictions,<sup>6</sup> as amended, which cover the real property, as the basis to believe Lake Region has the current right to the availability fee revenue. It is clear that Staff wishes its interpretation of the covenants and restrictions to coincide with the circumstances. Those wishes cannot stand against the force of the evidence. In actual fact, the shareholders of Lake Region hold the only valid legal claim to those fees. The author of those covenants and restrictions would agree.

14. At the close of paragraph 12, Staff states “There is nothing artificial about this [availability fee] revenue with respect to its intended use to support the utility operation.” Quite to the contrary, as Peter N. Brown has testified in his affidavit, that revenue was not intended to support utility operations.

15. Staff continues to ignore the historical record of the Commission’s treatment of availability fees. Prior to the current case the Commission has addressed the availability fees on Horseshoe Bend in three separate cases and on Shawnee Bend in one case.

*Case No. 17,954*

16. In Case No. 17,954 Four Seasons Lake Sites Water and Sewer Company, which was created by Four Seasons Lakesites, Inc., the developer of the area, sought authority from the Commission to provide regulated water service on Horseshoe Bend. Staff Witness Gary Bockman testified during the hearing on this case that “The feasibility study is one of the better ones that I’ve seen.” (Transcript, Case No. 17,954, at 35)<sup>7</sup> The only issue Mr. Bockman raised with the feasibility study was that he believed every customer should be metered and there should be no unmetered flat rate customers. Lake Region understands that the developer agreed

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<sup>6</sup> The Declaration of Covenants and Restrictions that have been so often referred to in this matter speak for themselves. Staff has misinterpreted them in Paragraph 12 but Lake Region will not point out those errors in this response.

<sup>7</sup>Attached is Schedule 1 to Lake Region Water & Sewer Co.’s Response To Staff’s June 7, 2010 Reply. This Schedule contains excerpts of the record and the Commission’s file in Case No. 17,954. A copy of the documents contained in the Schedule, certified by the Secretary of the Commission, will be offered into evidence by Lake Region at the June 24, 2010 hearing. An excerpt of the transcript of hearing can be found in Schedule 1.

to this since every Ozark Shores Water Company and Lake Region Water & Sewer Co. water customer is metered today. On page 22 of Mr. Bockman's analysis he states "The developer has obtained user agreements with the property owner in the development for an availability charge when the system is constructed and a regulated rate when they build." In addition, on Tables 4 and 6 of the feasibility study the availability fees are clearly identified as revenues available to the Company. Per Tables 6 and 7<sup>8</sup> the regulated rates were designed to recover the operating and maintenance expenses. All plant investment was allowed and none was treated as contributed plant. The availability fees were included in revenue to recover the capital costs of the investment. The Commission chose not to tariff the fees.

17. In Case WR-92-59 (Horseshoe Bend) the Staff chose not to include the availability fees in the case and made adjusting entries to the plant in service to reduce the rate base accordingly. The net effect was to allow recovery of the capital costs through the availability fees without actually regulating or tariffing them.

18. In Case WA-95-164 (Shawnee Bend) Staff designed rates to recover the operating and maintenance expenses, treated the plant investment as contribution and excluded the availability fees from the calculation. Again, the net effect is to allow recovery of the capital costs through the availability fees without regulating or tariffing them. Lake Region contends that this approach is the most appropriate of the various methods used by Staff.

19. In Case WR-99-183 (Horseshoe Bend, owned by Ozark Shores Water Company) Staff included the availability fees and did not make the adjusting entries to reduce rate base identically to their treatment in the original case, Case No. 17,954. The CIAC in the case was from customer connection fees per the Company's tariff.

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<sup>8</sup> Tables 4, 6 and 7 are found in Schedule 1 attached.

20. From what is recorded in Case No. 17,954, the Commission is justified to conclude that at the inception of the company, the developer intended for the availability fees to be regulated and probably tariffed. The record indicates that the Commission, not the developer, determined that the availability fees were not to be tariffed or regulated.

21. The Commission's treatment of availability fees has been consistent throughout the years until the rebuttal phase of the current cases. Staff's direct case filed on January 14, 2010 included the plant with an offset for the contributed plant and did not include availability fees just as Staff did in Case No. WR-95-164. The numerous scenarios proposed by Staff since the filing of its direct case demonstrate that Staff does not understand the theory or history behind the treatment of the availability fees.

22. For the sake of comparison, Lake Region will focus on Staff's proposal to include the availability fees as revenue and treat the plant investment as contributed. Had this proposal been used by Staff or the Commission in any of the previous four rate cases described above, **the tariffed rates to customers would have been at or near zero** and the entire cost of operating and maintaining the systems would have fallen on the undeveloped lot owners who were not taking water and/or sewer service. The rates in the current case would also be at or near zero on Shawnee Bend including the areas in which there are no availability fees.

23. Staff's proposal is not tied to any principle recognized in the ratemaking process. Rather, and Lake Region contends, Staff ignores obedience to principle in order to achieve its desired result that the Company's rates for service will never be higher than those approved in 1997. It has invented a method, unknown until now, by which to obtain that result. Staff's device is a de facto "Lake Region Reserve Fund," not authorized by statute or regulation, which is annually infused with shareholder-owned, not Company-owned, availability fees. Although



the shareholders will own and pay taxes on those availability fees, Staff will nonetheless employ them as a fictional Company reserve in order to cap Company rates at the level set in 1997, when the availability fees were not used in the ratemaking process. Staff's Lake Region Reserve Fund has an indefinite duration and therefore, it can be applied by Staff to deny relief in future rate cases for years to come. Staff's proposal invites the Commission to exercise powers over the assets of utility shareholders who are far beyond its province.

**Page 8, Paragraph 13**

24. The remarks made by Staff in Paragraph 13 of its reply do not refute that Lake Region does not own the rights to the availability fees, does not bill the fees and does not collect the fees. What Staff writes in Paragraph 13 is a distortion of the evidence. The availability fees prior to 1995 as reported on Company Annual Reports were for water infrastructure on Horseshoe Bend which was sold to Ozark Shores Water Company. Ozark Shores still owns the rights to those fees. For all subdivisions created after 1998 the developer retained the rights to the availability fees as per the agreement in 1998 when the stock was sold to Roy and Cindy Slates.<sup>9</sup> The fees related to these later subdivisions were never owned by the Company.<sup>10</sup>

**Page 9, Paragraph 14. A.**

25. In the last paragraph on page 9, Staff proclaims that "[t]he \$5.3 [sic] contributed plant has been fully recovered." Staff's statement is simply incorrect. Staff could not possibly have examined the Company's books and records to arrive at such a conclusion. As shown on Staff's filing of May 28, 2010, the Company reported \$2,388,127 of availability fees for 1973 – 2010. Staff knows, or should now be well aware, that all of the availability fees reported in the

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<sup>9</sup> See paragraph 2 of the *Affidavit of Peter N. Brown*, filed May 17, 2010.

<sup>10</sup> See also paragraphs 8-10 of *Lake Region Water & Sewer Company's Response To June 1, 2010 Order Of The Commission* filed on June 8, 2010.

Company Annual Reports from 1973-1992 were strictly associated with the *water infrastructure on Horseshoe Bend* which was sold to Ozark Shores Water Company. In this section of its reply, Staff appears to argue that \$2,197,724 of availability fees, which Staff knows have been used in ratemaking for Ozark Shores Water Company, should now be used again to offset the infrastructure costs of the Lake Region systems located on a completely different peninsula. Staff acknowledges in the Conclusion found in Paragraph 16 on page 15 of its reply: “As Horseshoe Bend does not have availability fees associated with its service area there are no additional revenues to consider for this operating system.” As shown in Staff’s May 28, 2010 filing, the only amounts on the Company’s books for availability fees related to water and/or sewer systems on Shawnee Bend were those for the years 1995-1998 totaling \$190,403.

**Page 10, Paragraph 14.B.**

26. In Paragraph 14. A. Staff asserted, albeit in error, that all of the \$5.3 Million in plant costs had been recovered through the collection of availability fees. In Paragraph 14. B. Staff claims that \$3.2 Million of the plant costs were collected in availability fees, and the balance recovered through the price of lot sales. There is a patent inconsistency between the subparagraphs. Most importantly, Staff bases its conclusions on mere assumptions and not actual facts confirmed by witnesses with knowledge. None of what Staff uses in this subparagraph is contained in the Company’s Annual Reports as ordered by the Commission. Lake Region addressed the accuracy of the numbers provided by Four Seasons Lakesites Property Owners Association (“POA”) in Paragraph 9 of its Response to June 1, 2010 Order of the Commission filed on June 8, 2010. This scenario is also non-responsive to the Commission’s Order and should be disregarded in its entirety.

**Page 10, Paragraph 14.C.**

27. In subparagraph C Staff offers a third scenario in response to the Commission's Order that requested only one. Staff again claims that the water and sewer infrastructure costs on Shawnee Bend have been completely recovered by or through a) the prices received for lot sales or b) the availability fee collections from 1974 to 1998 (the bulk of which were availability fees associated with Horseshoe Bend facilities, *see above*) plus a \$3.2 Million estimate of availability fee collections provided by the POA. Lake Region has addressed the inaccuracy of these numbers in the foregoing paragraphs and will not repeat that discussion here. However, it is timely to point out one more flaw in Staff's position. In each of Staff's theories on recovery of the investment costs, the amount recovered is very close to the original amount invested. Staff has assumed that the recovery of the contributed plant investment can be made at zero capital cost. The Commission is well aware that every dollar invested has an associated capital cost. The subparagraph C. scenario is also non-responsive to Commission's Order and should be disregarded in its entirety.

28. Company continues to believe that Staff's Direct Filing as adjusted for True Up on May 18, 2010, subject to proper inclusion of advances in aid of construction and the correct identification of contribution in aid of construction by operating system, contains the proper numbers for ratemaking in this case.

Respectfully submitted,

/s/ Mark W. Comley

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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 email, on this 22nd day of June, 2010, to:

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