BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Lake Region Water and Sewer Company's Application to Implement a General Increase in Water and Sewer Service	)))	Case No. SR-2013-0459
In the Matter of Lake Region Water and Sewer Company's Application to Implement a General Increase in Water and Sewer Service	)))	Case No. WR-2013-0461

LAKE REGION WATER & SEWER COMPANY'S POST HEARING BRIEF

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I. INTRODUCTION.

Lake Region Water and Sewer Company ("Lake Region" or "Company") is a corporation organized under the laws of the State of Missouri in good standing with its principal place of business at 62 Bittersweet Road, Lake Ozark, Missouri 65049. It possesses a certificate of convenience and necessity issued by the Commission on December 27, 1973, in Mo PSC Case No. 17,954 to provide water and sewer service in Missouri. Lake Region is a water corporation pursuant to Section 386.020(52) RSMo (Cum. Supp. 2013), a sewer corporation pursuant to Section 386.020(49) RSMo (Cum. Supp. 2013), and consequently a public utility within the meaning of 386.020(42) RSMo (Cum. Supp. 2013); thereby subject to the jurisdiction of the Commission pursuant to Section 386.250(3) and (4) RSMo (2000) respectively.[1]

Lake Region provides water service to approximately 658 customers and sewer service to approximately 635 customers in its Shawnee Bend service area; and sewer service to approximately 245 customers in its Horseshoe Bend service area. Lake Region's water system is comprised of: (1) two deep wells, each with a pumping capacity of 360,000 gallons per day; (2) a

[1] *Joint Stipulation of Additional Material Undisputed Facts*, February 5, 2014 (JSAMU) at ¶ 1.

200,000 gallon elevated water storage tank; and, (3) a total of approximately 96,847 feet of water mains. Lake Region's sewer system is comprised of: (1) seven sewage treatment plants: (a) Lodge, with a 326,500 gallon daily capacity, (b) Racquet Club, with a 292,500 gallon daily capacity, (c) Charleston Condominiums, with a 24,000 gallon daily capacity, (d) Shawnee Bend, with a 100,000 gallon daily capacity, (e) Grandview, with a 50,000 gallon daily capacity, (f) Maywood, with a 12,800 gallon daily capacity, and (g) Blackhawk, with a 1,387 gallon daily capacity; (2) multiple lift stations; and, (3) a total of approximately 8,924 feet of collecting sewers.[2]

Lake Region has provided good service to its customers. The Commission and its Staff have problem water and sewer companies. Lake Region is not one of them. Lake Region is a good company and has been for the length of James Merciel's tenure with the Commission. [3]

On July 16, 2013, Lake Region, in timely compliance with the Commission's report and order in Case Nos. SR-2010-0110 and WR-2010-0111 (the "*2010 Rate Case*"), filed revised tariff sheets designed to change its gross annual revenue and commence rate cases WR-2013-0461 and SR-2013-0459.[4] The proposed tariffs were designed to generate an aggregate revenue increase of approximately $218,762, or 23%.[5] On July 31, 2013, the Commission issued an *Order Suspending Tariffs and Delegating Authority* suspending Lake Region's revised tariff sheets for 120 days plus six months to an effective date or operation of law date of June 13, 2014.[6]

The Commission conducted a local public hearing at the City of Osage Beach City Hall,

[2] JSAMU at ¶¶ 4-6.
[3] **Tr. 301-304.**
[4] JSAMU at ¶ 7; Lake Region Exhibit 1, Summers Direct, at 3. The Company's existing water and sewer rates became effective September 6, 2010, as approved in Case Nos SR-2010-0110 and WR-2010-0111. In those same cases, the Commission ordered the Company to file a new general rate increase request no later than three years following the effective date of the report and order.
[5] Lake Region Exhibit 1, Summers Direct, at 4.
[6] JSAMU at ¶ 8.

1000 City Parkway, Osage Beach, Missouri, on Wednesday, December 11, 2013, beginning at 6:00 p.m. at which no witnesses testified.[7]

For this proceeding, the parties filed four separate stipulations of fact in aid of the record, one of which, filed on February 11, 2014, also expressed the parties' settlement of all but four issues dividing the parties.[8] The issues reserved for hearing were identified as availability fees, capital structure, return on equity and legal fees. Hearing on the four unresolved issues was conducted February 18, 2014.

As a preliminary matter during the day of hearing, the Commission took official notice of all its orders in the *2010 Rate Case* and all admitted exhibits and hearing transcript pages referred to in the January 31, 2014, joint stipulation of the parties; Exhibits 43 through 48 in the *2010 Rate Case*; and several pleadings.[9] Various sections of this brief rely on two sets of exhibits---those to which official notice has been taken, and those admitted by the Commission in the instant case---and to two separate transcripts of record. As a way of differentiating between the two sets in this brief, Lake Region will use **bold face** to cite to the transcript in the instant case and to the exhibits admitted by the Commission in the instant case.

II. DISCUSSION

A. Availability Fees

Issue: Should availability fees collected from owners of undeveloped lots in Lake Region's service territory be classified as Lake Region revenue or applied against rate base?

***WHAT'S PAST IS PROLOGUE*.[10]**

1. 2010 Rate Cases

[7] JSAMU at ¶ 9.
[8] *Unanimous Partial Stipulation and Agreement,* February 11, 2014.
[9] **Tr. 97.**
[10] *The Tempest*, William Shakespeare, Act 2, Scene 1.

In short, the answer to the question is "no."

This issue was fiercely contested in Lake Region's *2010 Rate Case*.[11] It is well known to the Commission and the parties that an extensive record was built on the subject at great expense. The Commission rendered a decision on the issue in an equally extensive and exhaustive order which directed that before availability fee revenue could be imputed to Lake Region a duly promulgated rule on the matter must be adopted. The order respected Lake Region's rights of due process, and the record in the *2010 Rate Case* and the Commission's order form the context within which the Commission must analyze the issue in the present cases. Whether availability fees are in any measure a factor in this case, or in any others, cannot be examined with completeness without comprehension of the *2010 Rate Case* and the other proceedings it engendered.

The findings of fact and conclusions rendered about availability fees written in the *Report and Order*, in the *2010 Rate Case* issued August 18, 2010 *(*hereinafter *"2010 Report and Order"),* reflect the enormity of the evidentiary base. The Commission devoted over twenty pages of text, which involved over 90 numbered paragraphs of findings, in discussing availability fees. Many, but not all, of those previous Commission findings are now part of the thickening record in this case. The parties jointly filed a stipulation of undisputed facts pertaining to availability fees,[12] and the Commission will note that its list of undisputed facts marches nearly lock step with the Commission's factual findings or determinations from the *2010 Report and Order*.[13]

This issue has not varied from one rate case to the other. In both of Lake Region's most

[11] Case Nos. SR-2010-0110 and WR-2010-0111, *Report and Order* issued August 18, 2010 (effective August 28, 2010).
[12] *See, Joint Stipulation of Undisputed Facts,* filed January 31, 2014.
[13] See discussion and comparison which follows *infra.*

recent rate cases, the factual base respecting availability fees is identical. In both cases, the statement of the issue is identical. In both cases, Staff's arguments and OPC's arguments regarding availability fee revenue are identical.

2. The Commission's Directive to Formulate a Rule

After examining the definition of "service" set out in Section 386.020(48),[14] the Commission wrote at page 101 of the *2010 Report and Order*:

> [w]hile the Commission has not done so in the past, availability fees could be construed to be a "commodity" and thus fall under the definition of a "service" despite its expert Staff's testimony to the contrary.

The Commission did not reach the conclusion that availability fees were a "commodity" and thus were within its jurisdiction; however, it held out for the possibility that they could be construed as such.[15] Staff and Office of Public Counsel offer a differing interpretation of this section of the order. Both appear to subscribe to the proposition that the Commission has unconditionally declared availability fees to be within its lawful jurisdiction,[16] a proposition refuted by the Commission itself.

Instructive portions of the Commission's discussion in later pages of the *2010 Report and Order* are set out below:

i. Departure from Past Decisions:

> To make this determination [that availability fees are a "commodity"] in this matter would be a substantial departure from past Commission decisions, policy and practice. And, although the Commission is not bound by *stare decisis* the rulings, interpretations, and decisions of a neutral, independent administrative agency, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which **courts and litigants** may properly resort for guidance." (Emphasis added). It has been

[14] Unless otherwise indicated, statutory citations herein are to RSMo 2000 or its current supplement.
[15] Lake Region acknowledges that in other parts of the *2010 Report and Order*, the Commission declared that it "should assert jurisdiction" over availability fees (p.103), but not without engaging in ancillary due process.
[16] Staff witness, James Merciel, a frequent subject matter expert on availability fees, testified however, that the Commission did not assert jurisdiction over availability fees in the 2010 cases. **Tr. 270.**

established that Lake Region has indeed relied upon this Commission's past decisions and the directions it received from the Commission's Staff for guidance with how availability fee revenue was not regulated revenue and would not receive ratemaking treatment. And, Missouri Courts have applied the doctrine of quasi-estoppel to prevent agencies from taking positions contrary to, or inconsistent with, positions they have previously taken.[17]

ii. Due Process

The Commission asserting jurisdiction over revenue derived from availability fees, as now declared in this matter, cannot simply be based on an adjudication on a specific set of accrued facts. What the Commission is announcing today is it is going to prospectively change its statement of general applicability that implements, interprets or prescribes law or policy, or that describes the organization, procedure, or practice requirements before this agency. Agencies cannot engage in this type of rulemaking by an adjudicated order. Pursuing a major change in the Commission's interpretation, implementation and prescription of its definitional statutes and its long-standing policy regarding ratemaking treatment of availability fees, requires compliance with the more stringent and lengthy process of rulemaking as required under section 536.021.

* * *

While not every generally applicable statement or announcement of intent by a state agency is a rule, an agency declaration that has the potential, however slight, of impacting the substantive or procedural rights of some member of the public is a rule. "Rulemaking, by its nature, involves an agency statement that affects the rights of individuals in the abstract."

Moreover, the Commission has not found an example of when it has ever completely reclassified revenue and imputed that revenue to the company for ratemaking purposes, and to do so now after Lake Region legitimately relied on the Commission's past treatment of this revenue would be the very definition of an arbitrary and capricious ruling. As the Missouri Supreme court has observed:

> An administrative agency acts unreasonably and arbitrarily if its decision is not based on substantial evidence. Whether an action is arbitrary focuses on whether an agency had a rational basis for its decision. Capriciousness concerns whether the agency's action was whimsical, impulsive, or unpredictable. To meet basic standards of due process and to avoid being arbitrary, unreasonable, or capricious, an agency's decision must be made using some kind of objective data rather than mere surmise, guesswork, or "gut feeling." An agency must not act in a totally subjective manner without any guidelines or criteria.

[17] *2010 Report and Order* at 101.

> To satisfy the standards of **due process** and avoid unpredictability with such a significant issue involved with determining a company's operational revenues, **the Commission will open a workshop docket** to lead to rulemaking. **In the rulemaking proceeding, the Commission will delineate the definitive policy for the prospective treatment of availability fees**, reservation fees, standby fees, connection fees, or any other similar fees, their proper use as mechanisms of capital recovery and their proper ratemaking treatment.[18]

The Commission ordered the opening of workshops by which to promulgate a rule to govern prospective treatment of availability fees, and those dockets were created and the workshops convened. The task assigned to Staff in those workshops was also expressed by the Commission in orders which followed the *2010 Report and Order*.

iii. The Rule is Indispensable to Exercise of Jurisdiction.

Lake Region submitted tariffs in compliance with the *2010 Report and Order* on August 23, 2010. On August 25, 2010, the Office of the Public Counsel (OPC) filed an objection to approval of the tariff sheets. It its *Order Approving Tariff Filings In Compliance With Commission Order,* the Commission overruled OPC's objection and offered these reasons:

> Public Counsel asserts that because the Commission declared, in its Report and Order, that it has jurisdiction over the availability fees and the revenue derived from the fees, that Lake Region must list the availability charges in its tariff sheets. Public Counsel's objection; [sic] however, is based upon a misunderstanding of the Commission's Report and Order. In the Report and Order the Commission stated:
>
> > The Commission asserting jurisdiction over revenue derived from availability fees, as now declared in this matter, cannot simply be based on an adjudication on a specific set of accrued facts. What the Commission is announcing today is it is going to prospectively change its statement of general applicability that implements, interprets or prescribes law or policy, or that describes the organization, procedure, or practice requirements before this agency. Agencies cannot engage in this type of rulemaking by an adjudicated order. Pursuing a major change in the Commission's interpretation, implementation and prescription of its definitional statutes and its long-standing policy regarding ratemaking

[18] *Lake Region 2010 Report and Order* at 104-106, emphases added. Footnotes and citations in this excerpt of the Commission's Report and Order have been omitted.

> treatment of availability fees, requires compliance with the more stringent and lengthy process of rulemaking as required under section 536.021.
>
> **The determination that the Commission made was that it was going to assert jurisdiction over availability fees in future actions after undertaking a formal rulemaking process.** The Commission specifically noted that it could not assert jurisdiction based upon the adjudicatory process in this single action. Public Counsel's objection is based upon a misreading of the Commission's order.[19]

The indispensability of the rulemaking was re-emphasized by the Commission in its *Order Regarding Motions For Rehearing, Motion For Reconsideration And Request For Clarification,* issued September 1, 2010. Lake Region, Staff and OPC had filed motions for rehearing or reconsideration of the *2010 Report and Order*. After repeating that portion of the *2010 Report and Order* which announced that a rulemaking was required before the Commission could change course on treatment of availability fees, the Commission further explained:

> Indeed, the Commission painstakingly delineated how rulemaking **is necessary for redefining service**, reclassification of revenue streams and a **complete reversal of its statement of general applicability** that implements, interprets or prescribes law, policy, procedure and practice after at least 37 years of following one practice, based upon its interpretation and applications of the law. The Commission provided additional clarification regarding the declaration of its intent to address its jurisdiction over availability fees prospectively where found appropriate in the future in its order approving Lake Region's compliance tariffs.
>
> On August 19, 2010, the Commission opened the workshops to lead to that rulemaking. And, on August 24, 2010, after issuing formal notice, the Commission **specifically directed its Staff to perform an exhaustive review of all current water and sewer regulations and prepare a comprehensive set of definitions, uniform and in conformity with Section 386.020(48), Cum. Supp. 2009**. As that order pointed out, the Commission has definitions for sewer service in its rules that may not conform with the statutory definition of service and that are inapposite to the arguments made by Public Counsel and Staff in this case that availability fees could constitute a utility "service." Those rules specifically define sewer service as being only the removal and treatment of sewage. **During the workshop/rulemaking process the Commission will examine proposed definitions and finally determine whether availability fees are a commodity**

[1919] *Order Approving Tariff Filings In Compliance With Commission Order,* Case Nos. SR-2010-0110 and WR-2010-0111, issued August 25, 2010 at page 2, emphasis added.

or if they fall under one or more of the other categories listed in the statute.[20]

[emphases added]

The Commission has announced unequivocally that it will not assert jurisdiction over availability fees in future actions until and unless the formal rule described in its report and order, and subsequent related orders, is promulgated. That rule constitutes a condition precedent to the Commission's assertion of jurisdiction over availability fees. That rule is nonexistent.

iv. The Workshop Dockets

File Nos. SW-2011-0042 and WW-2011-0043 were opened by the Commission for a distinctive purpose. In its *Order Regarding Working Docket*,[21] the Commission first rendered a brief history supporting the opening of the cases then set out the following directive to its Staff:

> Consequently, the Commission will direct its Staff, as part of these dockets, to conduct an exhaustive review of all of the Commission's regulations on water and sewer utilities and determine a comprehensive proposal for the pertinent definitions that will be applicable in any new water or sewer rules, and make recommendations for any required revisions in any existing Commission rules to bring all regulations into conformity with each other and the statute.

In the same order, the Commission ordered Staff to "**follow the directives in the body of this order during the workshop dockets and subsequent rule making proceedings**."

Pursuant to a Commission order consolidating similar investigations, and "to serve the purposes of administrative economy," File Nos. SW-2011-0042 and WW-2011-0043[22] were folded into a previously established workshop, Case No. WW-2009-0386.[23] Proceedings were

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[20] *Order Regarding Motions For Rehearing, Motion For Reconsideration And Request For Clarification*, issued September 1, 2010 at pp. 3-4.
[21] *Order Regarding Working Docket*, File Nos. SW-2011-0042 and WW-2011-0043, August 24, 2010.
[22] The records of the Commission show that File Nos. SW-2011-0042 and WW-2011-0043 were consolidated with WW-2009-0386 on the Commission's own motion and not by a Staff request to close those cases, as Mr. Summers thought was the case in his rebuttal testimony. **Lake Region Exhibit 2, Summers Rebuttal, at 3**.
[23] *Order Consolidating Investigations*, File Nos. WW-2009-0386, SW-2011-0042 and WW-2011-0043, June 16, 2011. The Commission took official notice of the orders and docket sheet entries for each of these three cases. **Tr. 282-283.**

conducted thereafter under that case number. On November 1, 2012, Staff moved to close the workshop. On November 28, 2012, the Commission directed Staff to prepare a report about the workshops including a complete list of all of the identified issues discussed during the workshops. On January 2, 2013, Staff submitted a summary of the workshop experience to the Commission as directed and identified four ultimate issues. At page 3 of its order closing the consolidated workshops,[24] the Commission acknowledged Staff's list of the issues:

> . . . Staff noted that the issues ultimately identified in the workshop and addressed were as follows:
>
> (1) Surcharges
> (2) PSC Assessment
> (3) Contingency/Emergency Funds
> (4) Rate Cases

Prominently absent from Staff's list of identified workshop issues is "availability fees" and a recommended rule to govern prospective treatment of availability fees.

The Commission will search in vain through the reports or submissions filed in Case No. WW-2009-0386 for any meetings convened to discuss availability fees or the promulgation of a definitive rule or any workshop consideration at all of availability fees or the development of party-participant consensus on a proposed rule designed to address availability fees. This is established in the testimony of Mr. John Summers, General Manager for Lake Region:

> **Q. Did Staff investigate the availability fee issue during the small utility workshop?**
>
> A. Not to my knowledge. The Company participated in the docket and based upon my monitoring of the progress of the case and its various filings, I do not recall that the issue was ever brought up for discussion. Filings subsequent to Staff's motion to close the docket confirms this. Upon

[24] *Order Granting Motion to Close File*, issued January 23, 2013.

> receipt of Staff's motion to close the docket the Commission directed the Staff to file a comprehensive report identifying the issues discussed at the workshop, the solutions and the entities participating in the discussions. Staff's report on the docket identified only four issues:
>
> 1. Surcharges
> 2. PSC Assessment
> 3. Contingency/Emergency Funds
> 4. Rate Cases[25]

Unmistakably, at no time did the workshop serve the purposes for which File Nos. SW-2011-0042 and WW-2011-0043 were created. The rulemaking procedure ordered and expected by the Commission did not occur. There has been no rule proposed or adopted by the Commission or the parties, particularly Lake Region, by which to determine how or whether availability fees can fit under any statutory definition of "service."

Staff has tried to explain why the rule is not in print or in force. In the testimony of its witnesses, and in the written responses it has submitted to Lake Region's ongoing and continuing objections to admitting evidence of availability fees in this matter, Staff has advanced several erroneous themes:

- Staff disagrees with Lake Region's argument that a rulemaking is necessary as a prerequisite to Commission consideration of the issue; however, Staff acknowledges that it was directed to engage in the workshops toward that rulemaking.[26]
- Staff contends that no party objected to its motion to close Case No. WW-2009-

[25] **Lake Region Exhibit 2, Summers Rebuttal, at 4**.
[26] *See, Staff's Response To Lake Region Water & Sewer Company's Objections to Hearing Exhibits,* filed March 12, 2014 at ¶ 9. The cited filing is the most recent expression of Staff's explanation for the lack of the needed rule.

0386.[27] Submerged in Staff's contention is the implication that Lake Region was under a duty to object to that motion. Lake Region had no such duty. The motion was limited to closing the workshop docket and nothing more. Closing the workshop had no effect on previous Commission orders.

- In the motion to close the workshop, Staff advised the Commission that,

  > problems are common within the industry, each individual water and sewer company presents its own unique situation and solutions are easier to reach by focusing on the individual company. Therefore, Staff states that, at this time, those problems are better addressed in the context of a company's rate case or other company-specific filing with the Commission, as opposed to maintaining an open workshop that is not active or productive to address those problems.[28]

Testimony at hearing disproves that availability fees was ever one of the "problems" to which Staff refers. James Merciel is and has been the Staff's chief witness and advisor on availability fees. Yet, he was not involved in the preparation of Staff's November 28, 2012, report about the issues identified in the workshop.[29] In the workshop docket itself, he did not review any documents and did not have an active role but may have given some background information. He did not participate in the workshop directly.[30] He was unaware whether the Staff made the decision to drop a rulemaking proceeding for the availability fee issue and did not attend any Staff meetings where the issue of treating the availability fee issue on a case by case basis was discussed.[31] He could only guess at the identity of the person who approved treating availability fees on a case by case basis.[32]

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[27] *Staff's Motion to Close Case,* File No. WW-2009-0386, Paragraph 8 (November 1, 2012).
[28] *See, Staff's Response To Lake Region Water & Sewer Company's Objections to Hearing Exhibits,* filed March 12, 2014 at ¶ 10.
[29] **Tr. 278.**
[30] **Tr. 279, 281.**
[31] **Tr. 280.**
[32] ***Id.***

- Even though Staff never listed "availability fees" as an "ultimately identified issue" in the workshops, Staff asserts that when the Commission closed the case it simultaneously determined the issue of availability fees was best addressed on a case by case basis rather than in a complicated rulemaking.[33] In other words, Staff argues that by implication the Commission vacated its orders in the *2010 Report and Order*.

The motions filed by the Staff and the Commission's subsequent orders all speak for themselves and truly require no outside interpretation. Without mistake, no party, especially the Staff, asked the Commission for relief from the Commission's directive to undertake a formal rulemaking process. That order has not been vacated, modified, altered or rescinded. Already subject to that order's burdens, Lake Region is equally entitled to its protection.

3. The protection of the Commission's *2010 Report and Order.*

The Commission has announced unequivocally that it will not assert jurisdiction over availability fees in future actions until and unless the formal rule described in the *2010 Report and Order*, and subsequent related orders, is promulgated. That rule constitutes a condition precedent to the Commission's assertion of jurisdiction over availability fees. That rule is nonexistent. Lake Region is entitled to rely on the Commission's order(s).

Whether or not Staff was authorized to terminate an effort toward a rulemaking about availability fees, a case by case analysis of the issue simply revives the real problem: "[A]sserting jurisdiction over revenue derived from availability fees, . . ., cannot simply be based on an adjudication on a specific set of accrued facts." Applying availability fee revenue to Lake Region's cost of service would be would be "a substantial departure from past Commission decisions, policy and practice."

[33] *See, Staff's Response To Lake Region Water & Sewer Company's Objections to Hearing Exhibits*, filed March 12, 2014 at ¶ 11.

> Agencies cannot engage in this type of rulemaking by an adjudicated order. Pursuing a major change in the Commission's interpretation, implementation and prescription of its definitional statutes and its long-standing policy regarding ratemaking treatment of availability fees, requires compliance with the more stringent and lengthy process of rulemaking as required under section 536.021. [34]

In this subsequent case, the Commission, by its own order, must refuse to exercise jurisdiction over availability fees. In this subsequent case, the Commission, by its own order, must refuse to classify availability fee revenue as Lake Region revenue or apply that revenue against its rate base. Otherwise, by its own declaration, the Commission deprives Lake Region of the fundamental processes due under constitutional law.

RE-LITIGATING THE ISSUE IN 2014

4. Laying the Issue to Rest

At the end of her opening remarks, Ms. Amy Moore, Staff counsel, concluded by saying, "the needs of the customer and of the Company would be best met by having this issue laid to rest." [35] The Company agrees.

Still reserving its position that, without the obligatory rule in place, the Commission is constitutionally forbidden from including availability fees as Lake Region revenue, the Company asserts that in the instant re-litigation of this issue, the Commission's options include laying it to rest by declaring once and for all that the Commission lacks jurisdiction over availability fees. The evidence stipulated to by the parties, and that adduced at hearing, fully support such a declaration.

Still another Commission option is determining once and for all that the Staff's availability fee imputation of revenue proposal, as well as OPC's proposal that would reduce

[34] *Lake Region 2010 Report and Order* at 104.
[35] **Tr. 126**

Lake Region's rate base by an estimate of total availability fees collected since their inception, are both patently unreasonable and therefore peremptorily rejected.

5. A Summary of Alternative Relief Requested

Lake Region[36] does not charge or collect availability fees for the unused water and sewer system infrastructure in place at Shawnee Bend. The Company has no control over availability fee revenue. The Commission lacks subject matter jurisdiction over the billing and collection of fees charged for the recovery of the costs of installing water and sewer infrastructure that is donated to public utilities.

If the Commission rejects arguments pertaining to Commission jurisdiction, Lake Region submits that the Commission should treat availability fees in this case in the fashion it has treated availability fees historically, namely, if availability fee revenue is classified by the Commission as revenue of the Company, then the donated plant associated with those availability fees should be added to the Company's rate base. Alternatively, if availability fee revenue is excluded from Company revenues, the plant associated with those availability fees, if somehow in the Company rate base, should be excluded from rate base.

6. History

In an order dated December 17, 1973, in Case No. 17,954, the Commission approved the application of Four Seasons Lakesites Water and Sewer Company for a certificate of convenience and necessity to construct, operate and maintain a water system on property located on Horseshoe Bend, Lake of the Ozarks.[37] Under the terms and provisions of a declaration of restrictive covenants, as amended, filed by the developer, Four Seasons Lakesites Inc., ---then

[36] As explained shortly in the History section of this brief, Four Seasons Lakesites Water & Sewer Company changed its name to Lake Region Water & Sewer Co. in March of 1999. Where the context requires, the terms "Lake Region" or "Company" shall also refer to the Company while it was named Four Seasons Lakesites Water & Sewer Company.

[37] Lake Region Ex. 217.

owned or controlled by Harold Koplar,[38] undeveloped lots located in the subdivision certificated were subject to an obligation to pay availability fees. Those fees are referred to as "availability contract revenue" in the feasibility study prepared by Mr. Richard French for this project.[39]

In Case No. WM-93-59, the Commission granted Ozark Shores Water Company (Ozark Shores) authority to acquire Four Seasons Lakesites Water and Sewer Company's water system assets and approved Ozark Shores' application to provide water service in the Horseshoe Bend service area. Ozark Shores owned and still owns the rights to charge and collect the water system availability fees due from owners of the undeveloped lots on the undeveloped lots on Horseshoe Bend. [40]

In Case No. WA-95-164, the Commission granted the Company's application to provide water and sewer service on Shawnee Bend, Lake of the Ozarks. The developer of the area donated the water and sewer system infrastructure to the Company.[41] The property certificated was subject to recorded deed restrictions. Pursuant to the Third Amended and Restated Declaration of Restrictive Covenants recorded by the developer on August 20, 1996, at Book 431, Page 292, Camden County Recorder's Office, the owners of undeveloped lots were obligated to pay an availability fee for the *water system* in an amount provided for in a tariff approved by the Commission, or if not so provided, then in an amount set by the owner of the water system.[42] Payment of the availability fees for water and sewer system availability was also part of the contract obligations of each lot purchaser by virtue of the real estate contract for the

[38] Four Seasons Lakesites POA Ex. 1.
[39] Lake Region Ex. 13, at 9.
[40] Tr. 359, 485
[41] The developer continued to contribute plant to the Company as the development on Shawnee Bend progressed. By the end of 2002 the Company had recorded approximately $5,300,000 in water and sewer plant contributed by Four Seasons Lakesites. (Lake Region Ex. 2, Summers Rebuttal, page 4). This appears to be the dominant number for the Shawnee Bend CIAC entry in the evidence in both rate cases.
[42] Merciel Rebuttal, Staff Ex. 15, Attachment No. 3, page 19.

lot.[43]

The purpose of the availability fees was to recover the investment made by Four Seasons Lakesites, Inc. ---the developer of the project--- in the water and sewer systems, not to subsidize the operations of the systems.[44]

In March of 1999, the Company officially changed its name to Lake Region Water & Sewer Co.[45] This was done after the sale of all outstanding stock in the company to Roy and Cindy Slates.[46] Also at this time, Roy Slates filed a registration of the fictitious name of Lake Utility Development.

Sometime between 1999 and 2001, the Slates transferred all of the outstanding stock of the Company to Mr. Waldo Morris, as well as their rights to any availability fees. The Company's annual report for 2001[47] shows Mr. Morris as the sole voting shareholder.[48]

With respect to his shares in the Company, Mr. Morris entered a Stock Purchase Agreement with Ms. Sally J. Stump and Mr. Robert P. Schwermann on September 10, 2004. As part of that agreement, Mr. Morris agreed to assign to Ms. Stump and Mr. Schwermann all of his rights in availability fees that were acquired from Roy Slates and Cindy Slates. The stock transfer closed and the assignment of the availability fees was effected on October 13, 2004.[49]

The entitlement to the availability fees was a matter of dispute between Lake Region, the shareholders of the Company –Mr. Waldo Morris --and the developer of the Shawnee Bend area, Four Seasons Lakesites Inc. at the time of the stock transfer in 2004. The dispute formed the

[43] Merciel Rebuttal, Staff Ex. 15, Attachment No. 7; Tr. 276, Lines 4-7.
[44] Staff Ex. 27, Affidavit of Peter N. Brown, paragraph 3.
[45] Merciel Surrebuttal, Staff Ex. 16, Attachment No. 2
[46] Staff Ex. 27, Affidavit of Peter N. Brown, Paragraph 2.
[47] In the *2010 Rate Case* the Commission took official notice of all of the Company's annual reports to the Commission for purposes of the case. Lake Region requests the Commission do likewise for the present rate case. Information about Mr. Morris and his ownership of shares in the Company can be found at page F-6 of the Company's 2001 annual report.
[48] Merciel Surrebuttal, Staff Ex. 16, Attachment No. 2
[49] Staff Ex. 10, HC, second page.

basis of a petition filed in Camden County Circuit Court. The matter was settled by agreement in which the Developer retained the rights to a specified amount of the availability fees charged and collected by Ms. Stump and RPS Properties LP [50] payable in installments.[51]

Under the business name of "Lake Utility Availability" Ms. Stump and RPS Properties submit bills for and collect the availability fees that were assigned to them. The fictitious name is registered with the Missouri Secretary of State's office. Billing for the fees is done with the help of Cynthia Goldsby, an employee of Camden County Public Water District No. 4.

v. Declarations of Covenants and Restrictions

Several generations of deed restrictions have been recorded with respect to real property located in the Company's certificated area. In references found in the documents admitted in the record, it appears that Four Seasons Lakesites, Inc.'s first such declaration of restrictions was recorded on December 2, 1969. It was thereafter amended by an instrument recorded on March 19, 1971[52] and on pages 22 -24 thereof, in section VIII, the Developer provided:

> VIII. Central sewage disposal system and water works system. The Owner of each lot agrees to pay to the owner or owners of the sewage disposal system and water works system to be constructed with the Development, a minimum monthly availability charge for water, water service and the accommodations afforded the owners of said lots by said water works system, commencing upon the availability of water in a water works system distribution main provided for the lot and continuing thereafter so long as water is available for use, whether or not tap or connection is made to a water works system distribution main and whether or not said owner actually uses or takes water; and, a minimum monthly availability charge for sewage disposal and treatment and the accommodations afforded the owners of said lots by said sewage disposal system commencing upon the availability for use of a sewage collection main provided for the lot which leads to an operating sewage treatment facility, and continuing thereafter so long as such sewage collection main is so available for use, irrespective of whether or not connection is made to or use made of said sewage

[50] Mr. Schwermann transferred his interest in the stock and availability fees to RPS Properties, LP, a family limited partnership. Ms. Stump and RPS Properties LP were the voting shareholders of the Company until December 31, 2012. On that date, Sally Stump transferred her shares in Lake Region to Vernon Stump, who is President of the Company. **Staff Exhibit 1, Cost of Service Report, at 2**.

[51] Staff Ex. 23 HC

[52] Four Seasons Lakesites POA Ex. 1, pages 22-24.

> collection main in connection with or for the purposes of any said lot. No charge will be made to the lot owners for the right to connect to the sewer and/or water system. Each lot owner will bear the cost of the service line from his building into the sewer and/or water main. The said owner or owners of said water works system and sewage disposal system will be a privately owned public utility authorized by a Certificate of Public Convenience and Necessity issued by the State of Missouri Public Service Commission to operate sewer disposal systems and/or water works systems, the aforesaid amounts of said availability charges, times and methods of payments thereof by said owners and other matters shall be as provided in Schedules or Rates and Rules, Regulations and Conditions of Services for Water Services and for Sewer Service filed and published by said public utility or utilities with said Missouri Public Service Commission, or any successor Regulatory Body of the State of Missouri, in accordance with law and passed to file or formally approved by said Commission as the then effective Schedule of Rates and Rules, Regulations and Conditions of Service of said public utility or public utilities. The amounts of said availability charges and other charges are subject to change hereafter by order of the said Missouri Public Service Commission or its successors in accordance with then exiting law and the structure of said availability charges are likewise and in the same manner subject to change from availability rates to another type of rate or rates. Unpaid charges shall become a lien upon the lot or lots to which they are applicable as of the date the same become due.

In July, 1996, Four Seasons Lakesites, Inc. executed a *Third Amendment and Restated Declaration of Restrictive Covenants* which was recorded August 20, 1996.[53] On page 2 of that restatement, the Developer chronicles the multitude of amendments to the declarations previously recorded, and on page 3 "rescinds all prior instruments mentioned above inconsistent with the following Third Amended and Restated Declaration of Restrictive Covenants." On page 18 of this amendment and restatement, the Developer set out provisions pertaining to the water and sewer systems. The provision is nearly identical to the one quoted above with a significant difference Lake Region notes in bold face type:

> IX. WATER SYSTEM AND SEWAGE TREATMENT SYSTEM:
>
> A. The Owner of each lot agrees to pay the Owner of the water works system to be constructed within the Development, a minimum monthly availability charge for water, water service and the accommodations afforded the

[53] Merciel Surrebuttal, Staff Ex. 16, Attachment No.3.

> Owners of said lots by said water works system, commencing upon the availability of water in a water works system distribution main provided for the lot and continuing thereafter so long as water is available for use, whether or not tap or connection is made to a water works system distribution main and whether or not said Owner actually uses or takes water. No charge will be made to the lot Owners for the right to connect to the water system. Each lot owner will bear the cost of the service line from his building into the water main. The said Owner or Owners of said water works system will be a privately owned public utility authorized by a Certificate of Public Convenience and Necessity issued by the State of Missouri Public Service Commission ("PSC") to operate the water works systems.
>
> The aforesaid amounts of said availability charges, times and methods of payments thereof by said Owners, and other matters, shall be as provided in Schedules of Rate and Rules, Regulations and Conditions of Services for Water Services, filed and published by said public utility or utilities which said Missouri PSC, or any successor Regulatory Body of the State of Missouri, in accordance with law and passed to file or formally approved by said PSC as the then effective Schedule of Rates and Rules, Regulations and Conditions of Service of said public utility or utilities, **or if not so provided, as determined by the Owner of the water works systems.** The amounts of said availability charges and other charges are subject to change hereafter by order of the said Missouri PSC or its successors, in accordance with then exiting law and the structure of said availability charges are likewise and in the same manner subject to change from availability rates to another type of rate or rates.
>
> Unpaid charges shall become a lien upon the lot or lots to which they are applicable as of the date the same become due.

At the time this restatement was filed, a plan for a sewer treatment plant had been approved but it involved the installation of individual treatment facilities not a centralized facility. No provision for sewer system availability fees is made in this restatement.

On July 22, 2009, in an instrument recorded on July 29, 2009, the Developer amended the Third Amended and Restated Declaration of Restrictive Covenants particularly with respect to the water and sewer systems (the Water and Sewer Amendment). On page 5 and 6 of the Water and Sewer Amendment, the Developer provided [bold face emphasis is added]:

> 3. Water Systems.
>
> 3.1 Shawnee Bend Lots – Central Water System. The Owner of each

Lot located on Shawnee Bend in a subdivision serviced by a central water system agrees to pay the owner of the central water system, **or its assigns or designees**, a monthly availability charge of Ten Dollars ($10.00) unless the Owner of the Lot is contractually obligated to Developer or Developer's assign to pay a different amount. This availability fee shall commence upon the availability of water in a water system distribution main provided for the Lot and shall terminate when the Owner connects his Lot to the water system distribution main. Each Lot Owner will bear the cost of the service line from his building to the water main. Unpaid availability fees shall become a lien upon the Lot the date they become due.

3.2 Horseshoe Bend Lots - Central Water System.[54] The Owner of each Lot located on Horseshoe Bend agrees to pay the owner of the water works system to be constructed within the Development on Horseshoe Bend a minimum monthly availability charge for water, water service and the accommodations afforded the Owners of said Lots by said water works system, commencing upon the availability of water in a water works system distribution main provided for the lot and continuing thereafter so long as water is available for use, whether or not tap or connection is made to a water works system distribution main and whether or not said Owner actually uses or takes water. No charge will be made to the Lot Owners for the right to connect to the water system. Each Lot Owner will bear the cost of the service line from his building into the water main. The said owner or owners of said water works system will be a privately owned public utility authorized by a Certificate of Public Convenience and Necessity issued by the State of Missouri Public Service Commission ("PSC") to operate the water works systems.

The aforesaid amounts of said availability charges, times and methods of payments thereof by said Owners, and other matters, shall be provided in the Schedules of Rate and Rules, Regulations and Conditions of Services for Water Services filed and published by said public utility or utilities which said Missouri PSC, or any successor Regulatory Body of the State of Missouri, in accordance with law and passed to file or formally approved by said PSC as the then effective Schedule of Rates and Rules, Regulations and Conditions of Service of said public utility or utilities, **or if not so provided, as determined by the owner of the water works system.** The amounts of said availability charges and other charges are subject to change hereafter by order of the said Missouri PSC, or its successors, in accordance with then existing law and the structure of said availability charges are likewise and in the same manner subject to change from availability rates to another type of rate or rates.

Unpaid charges shall become a lien upon the Lot or Lots to which they are applicable as of the date the same become due. Nothing in this paragraph shall be construed as a limitation on the rights of any such public utility to sell and assign in accordance with law its property and assets to a governmental subdivision of

[54] This refers to the water services provided by Ozark Shores on Horseshoe Bend. Ozark Shores is the owner of the rights to the availability fees charged to undeveloped lots on Horseshoe Bend.

the State of Missouri.

* * *

4. Sewer Systems.

4.1 Shawnee Bend Lots - Central Sewer System. The Owner of each Lot in a subdivision located on Shawnee Bend serviced by a central sewer system agrees to pay the owner of the central sewer system, **or its assigns or designees** a monthly availability charge of Fifteen Dollars ($15.00), unless the Owner of the Lot is contractually obligated to Developer, or Developer's assign, to pay a different amount. This availability fee shall commence upon the availability of a sewer distribution main provided for the Lot and shall terminate when the Owner connects his Lot to the sewer system distribution main. Each Lot Owner will bear the cost of the service line from his building to the sewer main. Unpaid availability fees shall become a lien upon the Lot the date they become due.

Prior to the extension of the central sewer system to such a Lot as described above, the Owner of the Lot may install an individual sewer system. Once the central sewer system is available to the Lot, the Owner must disconnect the individual sewer system and utilize the central sewer system.

The Developer expressly contemplated the filing of a fourth amended and restated declaration and further provided on page 8 that the "Water and Sewer Amendment will survive the execution and recording of the Fourth Amended and Restated Declaration."

The Fourth Amended and Restated Declaration of Restrictive Covenants was executed effective October 1, 2009, and recorded October 7, 2009.[55] On page 17, the Developer provided:

9. WATER AND SEWER SYSTEMS

All provisions relating to Water and Sewer Systems and treatment are set forth in the Amendment to Third Amended and Restated Declaration of Restrictive Covenants Relating to Water and Sewer Systems dated July 22, 2009, recorded July 29, 2009 in Book 681, Page 760 in the Office of the Recorder of Deeds of Camden County, Missouri (the "Water and Sewer Amendment"). All provisions of the Water and Sewer Amendment shall survive the recording of this Declaration.[56]

[55] Staff Ex. 12, Cover Page.

[56] The charging and collection of availability fees for the central water system and central sewer system for Shawnee Bend lots are currently governed by the provisions just quoted. Lake Region knows of no other amendment to the declarations made by the Developer pertaining to water or sewer services. Conspicuously absent from the Water and Sewer Amendment is any reference to Missouri PSC involvement with respect to availability fee charging and collection on Shawnee Bend lots.

In the same fourth amendment and restatement, the Developer set out an amendment to the manner in which the declarations of restrictions could be modified. On page 38, the Developer provided:

> 19.3 Term and Amendment. The provisions of this Declaration as amended from time to time shall affect and run with the land and shall exist and be binding upon all parties claiming an interest in the Development until January 1, 2015, after which time the same shall be automatically extended for successive periods of ten (10) years each unless the Owners of ninety percent (90%) of all Lots vote, at a special meeting of the Association called for that purpose, to terminate this Declaration. This Declaration may be amended at any time by the Developer at the request of or with the consent of the Board until such time as all Lots in the Development have been sold, at which time this Declaration may be amended by the affirmative vote of two thirds (2/3) of the Owners of all Lots in the Development entitled to vote. In the case of an amendment by two thirds (2/3) of the property owners, an amendment to this Declaration shall be duly executed by:
>
> (a) the requisite of such Owners required to effect such an amendment; or
>
> (b) the Association, in which latter case such amendment shall have attached to it a copy of the resolution of the Board attesting to the affirmative action of the requisite number of such Owners to effect such an amendment, certified by the Secretary of the Association.

vi. Developer's Lot Pricing and Contracts

From Peter N. Brown's affidavit, the Commission learned that the availability fees provided for in the declarations of restrictions and covenants were designed to recover Four Season Lakesites Inc.'s investment in the water and sewer systems and not to subsidize the operations of each system. The cost of the property when acquired by the developer was $300 to $350 per acre and was carried on the developer's books at that level, but at the time of the development of the area, the per acre market value was much greater.

The developer's plan was to recover the cost of providing water and sewer utilities from the lot purchasers by standby or availability fees. In addition to the obligations imposed on lot purchasers in the declarations, all or nearly all of the lot purchases are obligated **by contract** to

pay the developer or the developer's assigns any standby or availability fees.[57]

vii. Annual Reports of the Company

For the purposes of this portion of the brief, Lake Region will assume that the Commission, as it did in the *2010 Rate Case*, will take official notice of the annual reports filed with the Commission by Lake Region for the years 1972 to 2008. Pursuant to a May 5, 2010, Commission order, Staff filed a report,[58] with considerable additional information, (Annual Report Response) identifying any reporting by Lake Region, year by year, of the dollar amount of the collection of any availability fees. The Commission allowed Lake Region to respond to Staff's report. A few highlights of Staff's report and of Lake Region's response are important here.

In Staff's Annual Report Response, it attached an Appendix I with three separate Tables. Table 1 will be spotlighted in this brief. Setting aside Staff's estimated amount of availability fees for 1986, Table 1 shows that total availability fees reported in the annual reports of Lake Region since 1972 is $2,238,127. All of the availability fee revenue is reported as *non-regulated income* on line F-42, not $2,388,127 as reported by Staff. *All availability fee collection totals listed on Table 1 from 1974 through 1992 relate to the water infrastructure on* ***Horseshoe Bend***. Four Seasons Lakesites Water & Sewer Company sold the Horseshoe Bend water infrastructure to Ozark Shores in 1992 or 1993. See Case No. WM-93-59. Ozark Shores owns the rights to the availability fees collected on Horseshoe Bend and charges for those fees.[59] Ozark Shores continued to report the availability fees as non-utility income in its annual reports until 2005 when it was instructed by Commission personnel to file an amended annual report excluding

[57] Staff Exhibits 27 and 28, affidavits of Peter N. Brown and his supplemental responses.
[58] The Staff's response to the Commission's May 5 Order was filed on May 28, 2010. On June 1, 2010 the Commission directed Lake Region to respond and the response was timely filed June 8, 2010.
[59] Tr. 359, 485.

unregulated services/activities.[60] The Staff email containing this instruction was attached to Mr. Summers surrebuttal testimony as **JRS Exhibit 5**.[61]

The only availability fees related to the Shawnee Bend water and/or sewer operations which may have been owned by Lake Region are the amounts shown on Table 1 for the years 1995 through 1998 totaling $190,403.[62] In 1998, the stock of Lake Region was sold to Roy and Cindy Slates along with the rights to the availability fees. From 1998 forward, Lake Region's annual reports do not contain reports of availability fee revenue. [63]

viii. Treatment of availability fees historically by the Commission

Mr. Summers' rebuttal testimony in this matter described the history of availability fee treatment at the Commission:

Q. Do you agree that Staff's proposed treatment of availability fees is "substantially consistent" with the treatment of such fees in past cases as Staff claims in its report?

A. No. Staff's proposal is significantly inconsistent with the Commission's historic treatment of availability fees. **In every case reviewed by the Company in which availability fees have been considered by the Commission, the Commission either included both the fees and the associated rate base or excluded the fees and treated the plant investment as contributed plant.** I have updated the exhibit filed as JRS

[60] **Lake Region Exhibit 3, Summers Surrebuttal, at 6.**
[61] The Staff email was admitted in the *2010 Rate Case* as Lake Region Exhibit 9.
[62] Whether Lake Region ever owned the rights to the availability fee income is doubtful. The Commission took official notice of Staff Witness Greg R. Meyer's testimony in the Company's certification case, (Case No. WA-95-164) (**Tr. 216)** In that case, Mr. Meyer recommended that "the Developer and the Company need to enter into a written agreement whereby the Developer assigns the right to the Company to bill and receive availability fees." (Meyer Rebuttal, p 6). At that time then, Staff had serious questions about the ownership of the availability fee revenue stream. Additionally, in the sale to the Slates, it appears that the Developer considered the availability fees its exclusive property, and did so in the litigation with Lake Region, Ms. Stump and RPS Properties, LP.
[63]Tr. 356-357; Lake Region Ex. 8.

> Schedule 2 which was attached to my True Up Rebuttal Testimony in the 2010 Rate Case and am attaching it hereto as JRS Exhibit 1. The Commission has been consistent in every case for the Company and its predecessor over the past 41 years in using proper ratemaking technique of matching costs and revenues. In proposing their respective treatments or applications of the availability fees in this case, Staff and OPC have not only ignored the guidance of and precedent set by the Commission's decisions over the past 41 years but also the Commission's specific declaration in its order from the 2010 Rate Case that it could not implement such a drastic policy change without first going through a formal rulemaking procedure. Neither Staff nor OPC has offered testimony on any justification for departing from the Commission's previous rulings, or for their insistence that the Commission act without a proper rule in place. [emphasis added] [64]

Mr. Summers' **JRS Exhibit 1**, referred to in his rebuttal testimony, was amended. **JRS Exhibit 1** as amended is attached for ease of reference.

ix. Case No. 17,954

In Case No. 17,954 the Company 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." [65] 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.[66] In addition, on Tables

[64] **Lake Region Exhibit 2, Summers Rebuttal, at 6-7.**
[65] Lake Region Ex. 14, at 35.
[66] Lake Region understands that the developer agreed to this since every Ozark Shores Water Company and Lake Region Water & Sewer Co. water customer is metered today.

4 and 6 of the feasibility study, the availability fees were clearly identified as revenues available to the Company.[67] Per Tables 6 and 7, 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.

x. Case No. WR-92-59

In Case No. WR-92-59[68] involving Horseshoe Bend 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. The net effect was to allow recovery of the capital costs through the availability fees without actually regulating or tariffing the availability fees.

xi. Case No. WA-95-164

In Case No. WA-95-164 (Shawnee Bend Certification Case) Staff designed rates to recover the operating and maintenance expenses, treated the plant investment as contribution and excluded the availability fees from the calculation. The net effect was to allow recovery of the capital costs through the availability fees without regulating or tariffing them.

xii. Case No. WR-99-183

In Case No. WR-99-183, the Ozark Shores rate case (Horseshoe Bend), Staff included the availability fees as revenue and did not make the adjusting entries to reduce rate base just as was done in the original case involving Horseshoe Bend service area, which was Case No. 17,954 above. The Contribution in Aid of Construction in the case was from customer connection fees

[67] Lake Region Ex. 13 at 22.
[68] For additional information , please note that a copy 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 Commission's May 19, 2010 Order.

per Ozark Shores' tariff.

7. Commission Jurisdiction

It is so elementary an axiom that it requires no citation of authority that the Commission is a creature of the legislation that enables it and it has no powers beyond what are granted by statute. Although the Public Service Commission Law is classified as a remedial enactment, it cannot be validly interpreted to give the Commission powers beyond those expressed therein.

> Since it is purely a creature of statute, the Public Service Commission's powers are limited to those conferred by the [Public Service Commission Law], either expressly, or by clear implication as necessary to carry out the powers specifically granted, *State ex rel. City of West Plains v. Public Service Comm'n,* 310 S.W.2d 925, 928 (Mo. banc 1958). Thus, while these statutes are remedial in nature, and should be liberally construed in order to effectuate the purpose for which they were enacted, "neither convenience, expediency or necessity are proper matters for consideration in the determination of" whether or not an act of the commission is authorized by the statute, *State ex rel. Kansas City v. Public Service Comm'n,* 301 Mo. 179, 257 S.W. 462 (banc 1923).

State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 49 (Mo. 1979); *see also, State ex rel. Cass County v. Public Service Commission,* 259 S.W.3d 544, 547 -548 (Mo.App. W.D., 2008).

If the Commission lacks statutory power, it is without subject matter jurisdiction, and subject matter jurisdiction cannot be enlarged or conferred by consent or agreement of the parties. *Carr v. North Kansas City Beverage Co.,* 49 S.W.3d 205, 207 (Mo. App. 2001); *Livingston Manor, Inc. v. Dept. of Social Services, Div. of Family Services,* 809 S.W.2d 153, 156 (Mo. App. 1991).

The Commission's jurisdiction is set out in Section 386.215, and in particular,

> The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter:
>
> (6) To the adoption of rules as are supported by evidence as to reasonableness and which prescribe the conditions of rendering public utility

> service, disconnection or refusing to reconnect public utility service and billing for public utility service.

The term "service" is also statutorily defined.

> **"Service"** includes not only the use and accommodations afforded consumers or patrons, but also any product or commodity furnished by any corporation, person or public utility and the plant, equipment, apparatus, appliances, property and facilities employed by any corporation, person or public utility in performing any service or in furnishing any product or commodity and devoted to the public purposes of such corporation, person or public utility, and to the use and accommodation of consumers or patrons;

Section 386.020 (48).

The Commission is without subject matter jurisdiction over the billing and collection of availability fees. Having water or sewer system facilities available to an undeveloped subdivision lot does not constitute a "service" as defined in Section 386.020. This is certain particularly in this matter in which availability fees are charged to owners of undeveloped or vacant properties. An owner of an undeveloped property consumes no service from a water or sewer company. Staff witness James Merciel has testified on more than one occasion that availability of utility infrastructure is not, in his opinion, (if not in fact) a utility "service." [69] His testimony in this regard was mentioned by the Commission in its report and order in Case No. WC-2006-0082 and WO-2007-0277,[70] where the Commission held at page 57-58:

> As defined in Section 386.020(47): [71] "Service includes not only the use and accommodations afforded consumers or patrons, but also any product or commodity furnished by any corporation, person or public utility and plant, equipment, apparatus, appliances, property and facilities employed by any corporation, person or public utility in performing any service or in furnishing any product or commodity and devoted to the

[69] **Tr. 267.** Moreover, the Commission accounting department is on record that the revenue from availability fees is "unregulated." **Lake Region Exhibit 3, Summers Surrebuttal, at 6**.

[70] *Cathy Orler et al. v. Folsom Ridge LLC* consolidated with *In the matter of the Application of Folsom Ridge LLC and Big Island Water and Sewer Association, Inc. for an Order Authorizing the Transfer of Certain Water and Sewer Assets to Big Island Water Company and Big Island Sewer Company, and in Connection Therewith Certain Other Related Transactions,* Report and Order issued June 14, 2007, effective June 24, 2007. Mr. Merciel's testimony in this matter was the topic of cross examination at hearing on February 18, 2014. **Tr. 266-228.**

[71] Now 386.020(48).

> public purposes of such corporation, person or public utility, and to the use and accommodation of consumers or patrons." The reservation of a tap-on is not the provision of water or sewer service and does not involve a use, accommodation, product or commodity. Indeed, Mr. Merciel, from the Commission's Staff, testified at hearing that other Commission regulated companies charge similar reservation/maintenance fees, that these are untariffed charges and that these fees do not constitute a charge for utility service.

The Commission has ruled similarly in another case.

In Case No. SO-2007-0071,[72] Central Jefferson Utilities (Central Jefferson) requested authority from the Commission to transfer certain of its water and sewer assets to Jefferson County Public Sewer District. The assets were water and sewer mains and other equipment used to provide water and sewer service to Raintree Plantation Subdivision which was developed by Raintree Plantation, Inc. (Raintree) Raintree donated the water and sewer mains to Central Jefferson. To recover its costs from installing the water and sewer mains, Raintree required the buyers of each lot to pay a connection fee for connecting to the water and sewer mains. Raintree's connection fee was collected pursuant to an "Intrastate Exemption Statement" executed by Raintree and the purchaser of the lot. Raintree's connection fee totaled $1,100.00 and was composed of a $700.00 fee for sewer service, $300.00 fee for water service and a $100.00 fee per fire hydrant. The owners of Central Jefferson and the owners of Raintree were the same individuals. As part of the transfer the Sewer District and Raintree entered a Sewer and Water Service Fee Agreement in which the Sewer District agreed to collect certain connection fees and then pay them through to Raintree. The Sewer and Water Service Fee Agreement was not favored by the Commission. At page 36 of the Report and Order the Commission concluded however:

[72] *In the Matter of the Application of Central Jefferson County Utilities, Inc., for an Order Authorizing the Transfer and Assignment of Certain Water and Sewer Assets to Jefferson County Public Sewer District and in Connection Therewith, Certain Other Related Transactions*

> While the Commission lacks jurisdiction and authority over the Sewer District and Raintree, and has no standing to challenge the "side dealings" surrounding this transaction, the Commission expresses its extreme displeasure with the Sewer and Water Service Fee Agreement executed between these parties. This agreement funnels connection fees from the property owners back to Raintree for the questionable consideration of enforcing a contract with Aquasource, a duty Raintree already has, and for ill defined contributions that Raintree has made to Central Jefferson for various engineering and legal expenses. Simply put, this transaction does not pass the "smell test." Perhaps another party with standing will have the opportunity to challenge this transaction considering the proximity of the corporate entities and owners of Raintree and Central Jefferson.

In the case now before the Commission the result should be exactly the same. Here a developer, by contract and by provisions of real property deed restrictions, has imposed on buyers of undeveloped property within the subdivisions served by Lake Region an obligation to pay fees to recover the costs the developer incurred for installing water and sewer infrastructure. Like Raintree, that developer donated the water and sewer plant to the regulated utility. Like Raintree, the developer is beyond the jurisdiction and authority of the Commission. The developer's transactions in the buying and selling of rights to availability fees is likewise beyond the authority of the Commission to control.

The Commission lacks subject matter jurisdiction over the billing and collection of fees designed to recover the costs of a developer's investment in water and sewer assets that have been donated to a private utility. The Commission has no authority to consider Staff's or OPC's proposals concerning an allocation or application of such fees to Lake Region's operations in this case. Any evidence offered in this case respecting availability fees charged and collected on Shawnee Bend is irrelevant and should be stricken. The availability fees charged to undeveloped lot owners on Shawnee Bend within the Company's service territory is not a proper issue before

the Commission, and it should have no influence on the Commission's decision respecting the Company's request for rate relief.

8. **Indisputable Facts**

If the Commission rejects the Company's jurisdictional arguments, then it is Lake Region's position that Staff's and OPC's proposals cannot be accepted.

A number of undisputed facts should be highlighted here.

The Developer's purpose for establishing the availability fees was to recover the investment in the water and sewer systems, not to maintain or repair the existing operations of the systems once they were constructed. This fact was found the by the Commission in the *2010 Rate Case,*[73] and reaffirmed as an undisputed material fact in the parties' joint stipulation filing of January 31, 2014.[74] Staff witnesses though found this "undisputed" fact difficult to accept. In direct contradiction to the facts agreed to by the parties, Ms. Bolin, a staff witness, testified in surrebuttal that,

> [t]he only logical explanation for the purpose of the availability fees is the expectation that there is a water and sewer system that is continually supported and remains available to connect to when the need arises.[75]

At hearing, during cross examination, she explained that,

> Staff takes the position that, while the developer may [have] intended to recover his investment through the availability fees, these availability fees can be used in whatever manner that the utility desires.[76]

Staff's position is based on fiction.

It is undisputed that the Company derives no income or revenue from availability fees.

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[73] *2010 Report and Order, ¶ 162.*
[74] *Joint Stipulation of Undisputed Facts,* January 31, 2014, ¶ 42.
[75] **Staff Exhibit 8a, Bolin Surrebuttal, at p. 5.**
[76] **Tr. 243-244.** Lake Region submits that considerable energy and resources are expended in the preparation of any stipulation of facts. The one submitted to the Commission on January 31, 2014 was no exception and easily consumed "exceptional" energy and resources of all parties. Lake Region submits that the Commission should reject any testimony, written or live, which contradicts stipulated facts.

The Company has no rights to the availability fees. The availability fees affecting lots in the Company's Shawnee Bend service area are paid to persons who are entitled to those fees pursuant to a set of recorded deed restrictions that have been amended many times or by virtue of contract obligations that accrued at closing on the lot sale.

Those restrictive covenants do not govern the Company's operations, services, quality of service or rates for service.[77] The guarantee of Company service is by virtue of its approved tariffs, not the covenants or restrictions.[78] The Commission has found,[79] and can find and determine again, that each set of covenants, whether initial or amended, constitute agreements between the developer and the property owner. They also create obligations that flow between the property owner and Lakesites Property Owners Association. The covenants and restrictions are not a contract or agreement between Lake Region and the property owner and are not a source of authority in any fashion for the Company to provide water or sewer service.

The Company does not charge availability fees. The Company's customers do not pay availability fees to Lake Region. They pay only the rates and charges in the Company's tariffs as approved by the Commission. If any Company ratepayer happens to be paying an availability fee, it is entirely because the ratepayer made an independent decision to also purchase an undeveloped lot subject to the deed restrictions assessing the fee or subject to the contractual obligations the developer imposes at closing, or both. The Company has no power to enforce the payment of the availability fee against the lot owner even if the lot owner is also a Company ratepayer.

Under the provisions of the current set of declarations of restrictions, the owners of the properties subject to the availability fee have the means through their property owners'

[77] **Tr. 236**
[78] ***Id.***
[79] *2010 Report and Order*, ¶¶ 127, 141, 148.

association or independently to terminate the billing and collection of availability fees. Lake Region has no control over that decision.

The legal rights to the availability fees on Shawnee Bend have been assigned by the developer of that area to RPS Properties, LP and Sally Stump. For convenience, RPS Properties and Ms. Stump use the business name --- a registered fictitious name --- of Lake Utility Availability with respect to billing and collection of those fees. Ms. Bolin referred to Lake Utility Availability as an "affiliate" of Lake Region in her surrebuttal testimony.[80] There is nothing in the record to indicate that an "affiliated company" bills and retains availability fees. The evidence is unassailable that an individual and a family limited partnership, only one of which has shares in the Company, have partial rights[81] to bill and collect the availability fees due and owing from undeveloped lot owners on Shawnee Bend.

RPS Properties, as a shareholder, is separate and distinct from the Company. An owner of corporate shares does not become an affiliate of the corporation which he or she partially owns simply by virtue of stock subscription.[82] The law in this state sets up formidable walls of legal distinction between shareholders and the corporation they may own.

Ordinarily, a corporation is regarded as a separate entity, distinct from the members who compose it. The corporate entity will be disregarded when it appears the corporation is controlled and influenced by one or a few persons and in addition, that the corporate cloak is

[80] **Staff Exhibit 8a, Bolin Surrebuttal, at p. 10.** Staff is urging the Commission to constructively incorporate or adopt the "affiliate transaction" rules applicable to electric utilities (4 CSR 240-20.015) and gas utilities (4 CSR 240-40-015) for purposes of water and sewer companies. What constitutes an "affiliate" of a water and sewer company has not been officially defined. In the *2010 Rate Case,* Staff was specifically directed to perform "an exhaustive review of all current water and sewer regulations and prepare a comprehensive set of definitions, uniform and in conformity with Section 386.020(48), Cum. Supp. 2009." Had Staff undertaken the rulemaking as directed, the issue of what constitutes an affiliate might have been properly developed.

[81] Those rights to availability fees are still shared with the Developer.

[82] Moreover, there is no evidence in this record upon which to argue that Ms. Stump and RPS Properties, LP, either jointly or separately, constitute a "water corporation" or "sewer corporation" as those terms are defined in Section 386.020.

utilized as a subterfuge to defeat public convenience, to justify wrong, or to perpetrate fraud. However,

> [i]t must appear not only that the corporation is controlled and influenced by one or a few persons, but, in addition, it is necessary to demonstrate that the corporate cloak is utilized as a subterfuge to defeat public convenience, to justify wrong, or to perpetrate fraud. Furthermore, the corporate entity will not be disregarded where to do so would promote an injustice or contravene public policy.

S*ampson Distributing Co. v. Cherry*, 346 Mo. 885, 890-891, 143 S.W.2d 307, 309 (Mo.1940).

Lake Region serves the public convenience under regulation by the Commission. The record shows that it provides safe, reliable and adequate service.[83] Customers are not just satisfied but pleased by that service. Providing potable water and sanitary permanent sewer service is a public good, and cannot seriously be labeled as wrongful. Lake Region's corporate cloak has not been manipulated by its owners and to disregard its corporate organization promotes injustice to its shareholders. The personal assets of a shareholder of Lake Region ---a stream of income in this instance which was acquired after negotiation and pursuant to a stock purchase contract that was independent and apart from the regulated utility--- cannot lawfully be the source of revenue support for Lake Region's provision of water and sewer service to its customers. The effect of doing so offends basic constitutional protections.

The rights to charge and collect the availability fees under review in this case constitute the independently owned and validly acquired property of a real estate developer, a Company shareholder and an individual. To the extent the Commission may in fact, or constructively, classify the availability fee revenue as Company revenue, it takes the private property for public use without just compensation in violation of the 5th Amendment to the US Constitution and Article I, Section 26 Mo. Constitution (1945, as amended). Furthermore, RPS Properties and Sally Stump are not parties to this rate case. Utilizing revenue to which they are entitled from

[83] **Tr. 301-304.**

their own ventures in order to subsidize the Company's regular operations deprives them of their property without due process of law in violation of the 14th Amendment to the US Constitution and Article 1, Section 10, Mo. Constitution (1945, as amended).

9. Staff's and OPC's Proposals

Staff proposes that availability fees should be included as revenue in the calculation of rates for Lake Region. Specifically, Staff proposes that Lake Region's rates should reflect imputation of an annual amount of $93,136 for Shawnee Bend Sewer and $139,704 for Shawnee Bend Water.[84] This is the largest adjustment recommended by Staff in this case.[85] Staff acknowledges that there is no account on Lake Region's books or records where this revenue will be entered or credited.[86]

Public Counsel recommends that availability fees should be applied against rate base as contributions in aid of construction.[87] Mr. Ted Robertson, witness for OPC, calculated in his surrebuttal testimony that the availability fees collected from 1995 to the present totaled $6,599,749. He admitted that many of the amounts used in that calculation were estimates.[88] He proposed that the amount of availability fees collected in excess of the recorded CIAC for the Shawnee Bend facilities be used to reduce the Company's rate base. He recommended a reduction in the rate base for Shawnee Bend water in the amount of $331,350 and a reduction in the rate base for Shawnee Bend sewer in the amount of $705,843.[89]

Staff's and OPC's recommendations are unjust and unreasonable and must be rejected by the Commission.

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[84] *Staff's Statement of Position*, February 10, 2014 at p. 1.
[85] **Tr. 232.**
[86] **Tr. 233**.
[87] *The Office of the Public Counsel's Statement of Position*, February 10, 2014 at 1.
[88] **OPC Exhibit 4, Robertson Surrebuttal, p. 2.**
[89] ***Id.* at 7.**

The *2010 Rate Case* was the first case in which Commission jurisdiction over availability fees was contested.[90] Other companies regulated by the Commission might include availability fees as revenue, but the Commission has not imputed availability revenue to any regulated company that did not own the rights to that revenue.[91] Staff's and OPC's recommendations are identical to those each made in the only case in which the Commission's jurisdiction over availability fees was contested. In that case, both recommendations were rejected. The essential facts have not changed. The Commission has ample justification to reject those recommendations again, and, toward putting the issue finally to rest, to declare that those recommendations as they apply to Lake Region are patently unreasonable and unjust.

Mr. Summers describes in his testimony the effects of adopting Staff's and OPC's recommendations. In rebuttal he testified:

> **Q**. **What would be the effect of implementing Staff's or OPC's position regarding availability fees?**
>
> A. The effect of Staff's approach would be to deny the developer and/or his assigns or designees the opportunity to recover the original investment while giving the customers the double benefit of not only having the plant contributed, thereby reducing rates, but then further reducing the rates through the use of the revenue stream created by the developer to recoup the amount he was forced by the Commission to donate to these same customers. OPC's approach would . . . deny the developer and/or his assigns the opportunity to recover the original investment and again give the customers the double benefit of reducing rates through the forced

[90] **Tr. 270-271.**
[91] **Tr. 271.**

contribution of the plant when rates were originally set and also in the 2010 Rate Case and then further reducing the remaining rate base through the use of the revenue stream which was created to recoup the original investment. Either approach would result in rates which would be neither just nor reasonable and would threaten the financial viability of the utility.

Q. Why would the financial viability of the Company be threatened if availability fee revenue is imputed?

A. Because imputing this revenue is merely a fictitious entry made only on the Staff's and OPC's version of the Company's books which in turn holds the rates at an artificially low level. The Commission allowing the Staff and OPC to impute revenues does not actually give the Company access to the funds. I am unaware of any authority the Commission may have to compel the current owners of the rights to the fees, including the developer, to turn over this revenue stream to the Company. With Company rates held artificially low by imputing a revenue stream then eventually the actual cash flow generated by the Company will not be adequate for the Company to provide safe and adequate service. Lake Region could potentially be another candidate for receivership at some future date.[92]

Q. In your opinion, what would be the expected response of the shareholders if the Commission were to reduce rates below the level

[92] At the Commission's Third Annual Public Utility Law Symposium, held October 11, 2013 at Hulston Hall, University of Missouri Columbia --- School of Law, a Commission panel addressed issues facing small water and sewer companies including the effects on quality of service and public health generated by companies qualifying for or under receivership. Availability fees was not on the agenda.

approved in the 2010 Rate Case?

A. The most likely response would be the same as discussed by Dr. Stump in his testimony regarding Meadows Water Company. The shareholders would reduce operating efficiency by slashing costs and postponing maintenance to attempt to earn a reasonable return. At some point, the shareholders would determine they could invest their funds at a better return elsewhere and sell the Company.

Q. Would the sale of the Company require Commission approval?

A. An asset sale would require Commission approval, but the shareholders could sell their stock or do a tax free exchange of stock without Commission approval.[93]

In his surrebuttal testimony, Mr. Summers addressed OPC's recommendations in more detail. He testified there:

Q. **On page 4 of his rebuttal testimony, Mr. Robertson testifies that lot owners are "required to pay availability fees until they connect to the Shawnee Bend Water and Sewer systems, whenever that might be. Lot owners are paying these fees to guarantee that a state of the art utility system will be available when they are ready to connect." Has the Commission agreed with his testimony?**

A. No. On Page 99 of the Report and Order in the 2010 Rate Case the Commission commented and found that "Mr. Summers' testimony and the confidential settlement agreement of Civil Case No. CV103-760CC demonstrate that the original developer is still collecting a portion of fees

[93] **Lake Region Exhibit 2, Summers Rebuttal, at 10-11.**

and as Mr. Summers has deduced, the purpose must be related to the recovery of his initial investment since the developer has nothing to do with maintaining the water and sewer systems." I will also note here that the Commission stated in Paragraph 164 found on Page 54 of its Report and Order in the 2010 Rate Case "Lake Region customers have benefited from the availability fees, because the contributed plant associated with those fees lowers the rate base and lowers utility rates for the ratepayers." These Commission findings add strong support to the fact that imputing availability fees to Lake Region's revenue in any manner in the current case would yield an improper double benefit to the ratepayers. Furthermore, Mr. Robertson's testimony is similar to that of Staff Witness Featherstone in his surrebuttal testimony in the 2010 Rate Case. My testimony, and the Commission's determinations on Page 99 of its Report and Order from the 2010 Rate Case, clearly demonstrate the Commission considered and rejected this statement.

Q. Mr. Robertson further testifies on page 4 of his rebuttal "[t]herefore, these fees are designed to recover the original cost of the utility investment along with any other additional treatment capacity or other water and sewer infrastructure, such as line extensions and pumping stations, etc., required to build a state of the art system to serve customers at the time they are ready to take service." Has Mr. Robertson accurately stated the purpose for the availability fees charged to owners of unimproved lots on Shawnee Bend?

A. No, he has not. As I mentioned earlier the availability fees in the current case were created by the developer to recover the developer's costs for infrastructure already in place which the developer was forced to donate to the utility. They were not created to recover costs of demand additions and line extensions. Mr. Robertson's testimony appears to reflect or rely on the research he identified in the data request response. That research involves types of fees unlike those before the Commission in this case.

Q. Has the Commission treated availability fees as additional CIAC as proposed by OPC?

A. No, JRS Exhibit 1 filed with my rebuttal testimony illustrates the Commission's approach to availability fees since the Company's original certificate case in 1972. The Commission has never taken the approach of having the utility record plant as contributed and then using the availability fees created to recover that cost to give the customers a double benefit by recording these fees as additional CIAC.

Q. Mr. Robertson has testified that it is the Company's burden to prove the costs associated with plant investment, donated plant and availability fees. Do you agree?

A. No. Lake Region has no right or claim to availability fee revenue. Hence, it is not accounted for on its books and records. With respect to the proof of Lake Region's costs associated with plant investment and donated plant, I agree that Lake Region shoulders that burden and Lake Region has unmistakably met that burden successfully. The Company has gone

> through two previous rate cases in which its books of record were examined and the appropriate rate bases were determined for ratemaking purposes. The Company has provided both Staff and OPC complete access to the Company's books of record in this case and both Company and Staff have proposed rate bases comparable to those in previous cases.[94]

The Staff's and OPC's recommendations share this in common: Each rests on the assumption that Lake Region, despite the inarguable fact that it has no rights to the availability fee revenue, can by some means wrest the revenue from its rightful owners and in turn infuse it into its operations. If it cannot do so, Lake Region will suffer a shortfall shouldering its cost of service. If one or the other of the Staff's or OPC's recommendations is adopted, Lake Region's rate revenue will not cover its agreed cost of service. To believe that Lake Region has rights to collect availability fee revenue is perfect fiction, and to presume it has such rights and adjust Lake Region's rates for service based on that presumption is punitive. Mr. Summers' prediction that Lake Region will lose financial viability and risk statutory receivership is not fanciful.

Staff's recommendation to include availability fees that are billed and collected by RPS Properties LP and Sally Stump as Company revenue, and OPC's recommendation to reduce Lake Region's rate base by a figure based in part of estimated amounts of availability fees collected over time should both be rejected. Both have been rejected by the Commission once before. Both are inconsistent with previous Commission decisions on the topic. Each would result in an unfair shift of costs to persons not customers of the Company, i.e the owners of the lots in Shawnee Bend and very importantly, each would artificially reduce the Company rates to confiscatory levels in violation of the 14th Amendment to the US Constitution.

[94] **Lake Region Exhibit 3, Summers Surrebuttal, at 4-6.**

B. Capital Structure and Return on Equity

Issues: **Should the capital structure for Lake Region be based on its actual capital structure or a hypothetical capital structure?**

If the capital structure for Lake Region should be based on its actual capital structure, what is Lake Region's actual capital structure?

What is the appropriate return on equity for Lake Region?

1. Positions of the Parties.

Lake Region proposes that its capital structure in this matter be based upon its actual capital structure, and, on that basis, a balanced reasonable capital structure for ratemaking purposes is 60% debt and 40% equity. The appropriate return on equity for Lake Region is 13.89%.

Similarly, Office of Public Counsel proposes that Lake Region's capital structure be based upon its actual capital structure. It further proposes that Lake Region's return on equity remain at 8.5%, the rate approved by the Commission in the *2010 Rate Case*.[95]

Staff proposes a hypothetical capital structure for Lake Region. Staff contends that Lake Region is financed with 100% debt after giving consideration to the outstanding "acquisition" loan. Staff recommends a hypothetical capital structure of 75% debt and 25% equity. Staff proposes that Lake Region's return on equity be approved at 13.89%, but if Lake Region's capital structure proposal is approved, Staff recommends a return on equity at 11.93%. [96]

2. Staff's Rate of Return Recommendation

Staff proposes an overall rate of return of 7.223% for Lake Region. This overall rate of return is composed of a capital structure weighted 25% common equity, 75% debt, an embedded

[95] *The Office of the Public Counsel's Statement of Position*, February 10, 2014 at 2.
[96] *Staff's Statement of Position*, February 10, 2014 at p. 2.

cost of debt of 5%, and a return on common equity of 13.89%. [97]

Staff developed its overall rate of return recommendation based on a hypothetical capital structure, a Lake Region loan minimum debt interest rate of 5%, and Staff's Small Utility Return on Equity Methodology ("SUROEM").[98]

Staff proposes to rely on a hypothetical capital structure in this proceeding, because it alleges that Lake Region's actual capital structure is composed of 100% debt. Staff reaches this conclusion based on the comparison of its estimated rate base for Lake Region of $2.635 million and total debt for Lake Region of $2.7 million. Staff alleges that Lake Region's total debt includes a shareholder or acquisition loan ("shareholder" or "acquisition loan") of $1.3 million, and a utility-specific debt issuance ("utility loan") of $1.4 million. [99]

3. Staff's Proposed Capital Structure for Lake Region is Not Accurate—a Summary

Lake Region disputes Staff's argument that its actual capital structure is 100% debt. Lake Region demonstrated that its actual capital structure is composed of approximately 60% debt and 40% common equity[100]. Lake Region recorded on its balance sheet approximately $937,400 of common equity and approximately $1.4 million of debt (Lake Region initial filing capital structure). Staff does not dispute the amount of capital actually recorded on Lake Region's financial statements. Rather, Staff asserts that an acquisition debt loan is also a funding source for Lake Region. Staff proposes to substitute an acquisition loan in place of the actual common equity reported on Lake Region's financial statements to establish its "actual" capital structure[101]. By substituting a shareholder loan in place of the common equity recorded on Lake

[97] **Staff Exhibit 2, Accounting Schedules, Schedule 04.**
[98] **Staff Exhibit 1, Cost of Service Report, at pp. 4-7.**
[99] **Tr. 168.**
[100] **Lake Region Exhibit 2, Summers Direct at 12.**
[101] **Tr. 119-120, 185.**

Region's balance sheet, Staff concludes that the utility is financed with 100% debt.

Staff's conclusion and support for its development of Lake Region's actual capital structure is based on erroneous conclusions and unsupported conjecture, and should be disregarded. As explained below, the acquisition loan is not capital supporting Lake Region's utility rate base, and should not be substituted for the actual common equity recorded on Lake Region's balance sheet to develop its actual capital structure for ratemaking purposes.

4. The Acquisition Loan is not Lake Region Capital

Staff contends that the acquisition loan was originally entered into in 2004, at the time the current owners of Lake Region acquired the equity shares of Lake Region.[102] Staff recognizes that that original acquisition loan was refinanced several times (2006, 2008 and 2009) and again in 2013 in the test year in this proceeding. [103]

Staff's understanding of the acquisition loan is misplaced and inaccurate.

a. *The Negative Pledge Agreement.*

During the discovery phase of this matter, Lake Region received responses to requests for admission related to the Staff's recommended capital structure. It was Lake Region's understanding, up until the deadline for filing of rebuttal testimony if not longer, that Ms. Shana Atkinson, the Staff's chief witness on the issue, substituted the acquisition loan in place of the actual common equity reported on Lake Region's financial statements because of a Negative Pledge Agreement signed by the makers of the acquisition loan as it was refinanced in 2013.[104] During cross examination at hearing, Ms. Atkinson agreed that she had given the following statement given in response to a particular request for admissions:

[102] **Staff Exhibit 1, Cost of Service Report, at 6.**
[103] **Tr. at 165**.
[104] The current form of the acquisition loan and guaranties and pledges connected to the loan were made a single exhibit and admitted at hearing as **Lake Region Exhibit 7.**

> Lake Region has only two shareholders, both of whom have specifically signed negative pledge agreements to not pledge Lake Region assets as collateral in any other loans. The intent of the structure of this debt instrument is to preserve the Lake Region assets for the lender in the event of default; therefore, in this case, the shareholders debt should be considered a debt of Lake Region for the purposes of assessing Lake Region's capital structure.[105]

The Negative Pledge Agreement was released by the lender on January 1, 2014.[106] Even though the Negative Pledge Agreement was released, and the tie to Lake Region assets was broken, Ms. Atkinson did not move from her opinion. At hearing, she concluded basically that the Negative Pledge Agreement made no difference at all. She claims that because Lake Region has a loan with the same lender as the lender on the shareholder loan, the Lake Region assets were still at risk upon a default of the shareholder loan.[107]

The loan documents in **Lake Region Exhibit 7** will confirm that the makers of that note have pledged shares in Lake Region but no Company assets. The shareholders of the Company own none of the Company assets in the first place and lack title by which to pledge or collateralize them. [108] A default of the shareholder loan would entitle the lender to foreclose on the pledged shares and thus become the Company's owner, but the Company assets would be free from foreclosure. Furthermore, it would be nonsensical for a lender to disrupt a profitable regulated utility such as Lake Region by forcing a sale of its assets when the Company was current on its own obligations.

Ms. Atkinson initially gave significant importance to the Negative Pledge Agreement in her capital structure recommendation. Lake Region surmises it most likely was the only reason at that time Ms. Atkinson decided to add the shareholder loan to the computation of Lake Region's debt. Her recommendation, however, has not changed despite the release of the

[105] **Tr. 173-174.**
[106] The release was admitted into evidence at hearing as **Lake Region Exhibit 6**.
[107] **Tr. 171**.
[108] **Lake Region Exhibit 2, Summers Rebuttal, at 14.**

Negative Pledge Agreement. Lake Region suggests that her immovable stance on the subject detracts significantly from the quality of her opinions and the Commission should discount them accordingly.

b. *The Shareholder Loan*

At the time it acquired the equity shares of Lake Region, the Partnership did execute an acquisition loan. That loan was part of the cash sources available to the equity owners to fund their investment in Lake Region's equity shares and provided cash for other Partnership investments.[109] (). Lake Region has never stated, and Staff has not proven, that the acquisition loan was the only funding source used by the shareholders to acquire Lake Region's equity shares in 2004.

Indeed, Staff witness Ms. Atkinson, in reaching her conclusions, stated that her belief that the acquisition loan was used entirely by the shareholders to purchase the equity shares was based on a statement in the loan document that the loan was to purchase equity in the water/sewer company.[110] She failed however to demonstrate that Staff investigated whether or not the Partnership used common equity capital as part of the funding source for the Lake Region equity shares. [111] From all aspects, the acquisition loan was not solely used as a funding source for the water/sewer company.

Importantly, in 2004, Lake Region originally had balance sheets that suggested it was 100% common equity financed. That common equity was supported by capital at the Partnership level. Based on prior rate cases and conversations with Staff, Lake Region sought to modify its financing structure in order to produce a more transparent and verifiable capital

[109] **Lake Region Exhibit 2, Summers Rebuttal at 12-13; Lake Region Exh. 7, at. 10-11.**
[110] **Tr 184-185.**
[111] The acquisition loan amount was close to the acquisition price of the equity shares. Hence, more capital than the loan was needed to acquire the equity in Lake Region.

structure mix for Lake Region. It accomplished that in its refinancing case, WF-2013-0118, but Staff has not recognized this change in its financial structure in this rate case.

Lake Region's capitalization structure in this case is very different than prior cases, because management intentionally modified the capitalization mix to create a transparent financial structure.[112] Toward this objective, Staff ignored all the changes and financing decisions taken by Lake Region since its last rate case to accomplish this transparent structure. Those changes in financial structure include the following:

i. Lake Region issued a "utility loan" in May of 2013[113] in the amount of $1.4 million. The proceeds of the debt were used to repurchase common equity from Lake Region's shareholders. This fundamentally changed the capital structure mix for Lake Region, and the funding sources available to the shareholders to support their equity share investment.

ii. The utility loan was secured directly by the Lake Region assets and cash flow. In significant contrast, the acquisition loan is not secured by Lake Region, but rather is secured by a personal pledge of the equity Partnership which includes Lake Region and their other investment assets.[114]

iii. After the issuance of this utility debt, Lake Region's capital structure was restructured from approximately 100% equity, down to approximately 40% equity and 60% debt. Again, the proceeds of the utility debt were used to repurchase Lake Region's equity shares from the equity partners of Lake Region. This produced a transparent and verifiable actual capital structure for Lake Region.

[112] **Lake Region Exhibit 2, Summers Rebuttal, at 10.**
[113] This debt was approved by the Commission in Case No. WF-2013-0118 on February 13, 2013.
[114] **Tr. 170-171**.

iv. Since 2004, Lake Region has produced significant internal cash flows that have allowed for significant changes in the capital funding sources available to Lake Region since the original equity shares acquisition date in 2004. Therefore, the capital funding source has not been static since 2004, as Staff erroneously assumes.

v. In the decade between the original 2004 equity share acquisition date, and the test year in this case, Lake Region generated internal cash flows in the form of depreciation expense, retained earnings, and deferred taxes. These internal cash flows were available to support investments in Lake Region's utility plant and equipment. This internal funding also supported Lake Region's dividend payments and other cash transfers up to the equity owners. This internal cash produced from operations modified the original funding sources used by the shareholders since the equity shares were first acquired in 2004.[115]

vi. Contrary to Staff's belief, Lake Region's funding sources have not been static over the last 10 years, but rather have been part of a dynamic flow of internal and external cash sources that have been used by Lake Region to fund utility investments, and to modify Lake Region's actual capital structure. Staff's sole reliance on 2004 funding source data is stale, is no longer valid, and is also erroneous because Staff incorrectly assesses total capital funding sources used by equity shareholders in 2004, and does not reflect Lake Region's actual capital structure in this case.[116]

vii. Lake Region's efforts to modify its capitalization mix were specifically designed to create a transparent and verifiable capital structure for Lake Region. This financing

[115] **Lake Region Exhibit 5, Gorman Direct, at 11.**
[116] *Id.*

plan has been intentionally executed by Lake Region, is in place in this case, and is verifiable based on the loan documents provided to Staff in this case.[117]

viii. As pointed out earlier, Staff's belief that the acquisition loan is securitized by Lake Region's assets is incorrect. The acquisition loan is a Partnership loan that provides general funding sources to the owners of Lake Region's equity shares. The acquisition loan has been used to fund investments in Partnership investments, and not used by Lake Region to fund utility plant investments. Staff has provided no evidence to support its belief that the acquisition loan is dedicated entirely to investments in Lake Region, nor used by Lake Region as its only funding source to support its capital program or capital restructuring. The acquisition loan was not dedicated entirely to shareholders' interest in purchasing Lake Region's equity shares. Further, Staff made no investigation as to whether or not the Partnership used equity capital as part of the acquisition funding source.

Staff's evidence largely is based on its erroneous understanding of the original acquisition of Lake Region's equity shares in 2004. Further, Staff has completely disregarded all changes in funding sources and capitalization changes that have occurred at Lake Region since 2004. Staff's conclusions on Lake Region's actual capital structure are simply erroneous and without merit.

5. A Transparent Actual Capital Structure is Prudent and Benefits Investors and Ratepayers

Lake Region modified its capitalization structure for the utility company in order to provide the Commission and the Staff a transparent capital structure for Lake Region. This same capital structure, with the Commission's acceptance and approval, can be taken to

[117] **Tr. 150.**

lenders to support Lake Region's ability to refinance existing securities (loans), and secure external capital to fund utility rate base investments.[118] This will benefit Lake Region's shareholders and their customers by providing a transparent and reasonable capital structure. This should support Lake Region's ability to enter into new loans, and refinance existing loans, at the most favorable terms and lowest interest rates available. This in turn keeps Lake Region's cost of service low, and its rates as competitive as possible. Staff has provided no evidence nor made any assertions that this is not a reasonable and prudent objective for Lake Region to have implemented prior to this rate case. However, Staff does agree making financing decisions to keep interest rates low benefits customers.[119]

Staff's proposal for a hypothetical capital structure does not reflect the actual financing decisions made by Lake Region. Staff's proposal to lock into a hypothetical capital structure regardless of what actually takes place at the utility, deprives Lake Region's management of executing prudent and reasonable financing decisions that benefit its investors and its ratepayers. Staff's proposal for a hypothetical capital structure that ignores all actual prudent financing decisions executed by Lake Region is not reasonable and should be rejected.

6. Staff's Hypothetical Capital Structure Methodology Proves the Company's Actual Capital Structure is Reasonable

Staff relied on its Small Utility Return on Equity/Rate of Return Methodology ("SUROEM") to develop a hypothetical capital structure, target bond rating, and estimate a fair return on equity. Lake Region found this methodology to be reasonable because it was transparent and measured a fair return on equity based on an estimate of the utility's investment risk.

[118] **Tr. 158.**
[119] **Tr. 184.**

Staff found a reasonable proxy bond rating for Lake Region to be "B+." Lake Region agrees that a "B+" bond rating is a reasonable conclusion based on Staff's SUROEM. The finding then suggests that Lake Region has a below investment grade credit standing. Staff based this proxy bond rating on a utility that has a "Highly Leveraged" financial profile and has a business profile score of "Strong." These business and financial profile scores are consistent with Standard & Poor's credit rating metrics for corporate companies including utility companies.[120]

While Lake Region agrees with Staff's conclusion that a reasonable proxy bond rating for Lake Region is "B+," Lake Region found that Staff understated the business risk of Lake Region based on its SUROEM. Specifically, Lake Region believes that applying Staff's SUROEM suggests that its business profile score should be "Satisfactory," not "Strong." A "Satisfactory" bond rating implies greater business risk for Lake Region than that implied from Staff's "Strong" business profile score rating. [121] The reason Lake Region asserts that Staff understated the actual level of business risk for Lake Region is that Staff failed to follow its own SUROEM.

In Staff's Schedule SA-1, Appendix 2, Staff's methodology clearly prescribes the following:

> . . . Staff believes that due to the fact that some small water and sewer companies have trouble receiving debt financing, this should be considered in assigning BRPs for purpose of estimating the cost of equity for small water and sewer companies. Staff will determine the BRP of a company by assessing the company's access or potential access to debt capital. If a company proves to Staff that they cannot obtain a loan or the company can obtain a loan but has to pledge personal assets in order to do so, then Staff would classify the company's BRP as "Satisfactory." If the company can obtain a commercial loan without having to pledge personal assets, then the Staff would classify the company as having a "Strong" BRP. (emphasis added) [122]

[120] **Staff Exhibit 1, Staff Report Cost of Service, Appendix 2, Schedule SA-1, page 7 of 7.**
[121] **Lake Region Exhibit 5, Gorman Direct, at 4-5.**
[122] **Staff Exhibit 1, Staff Report Cost of Service, Appendix 2, Schedule SA-1, page 3 of 7.**

In Lake Region's Utility Loan, the shareholders of the company were required to provide an unlimited guarantee to secure the loan.[123] Staff does not dispute this fact.[124] As such, there is no dispute in the record that the equity owners of the utility were required to pledge personal assets in order to secure the Utility Loan. Staff did not explain or otherwise provide any evidence that suggests Lake Region could have issued the Utility Loan without the unlimited guarantee of the shareholders. Staff did counter, however, that the utility was told by its banker that it would have access to additional capital.[125] While that may be true, the additional capital would be made only under the terms of the existing loan which includes an unlimited shareholder guarantee. As such, Staff's SUROEM methodology clearly prescribes that the business profile score of Lake Region should fall into the "Satisfactory" category, because the utility loan required the pledge of personal shareholder assets. Lake Region's loan required a personal pledge.

Because Staff understated Lake Region's business risk per its SUROEM, it overstated the amount of financial risk Lake Region can assume and still maintain its "B+" target proxy bond rating assumed by Staff. [126] As a result, Staff's conclusion that a 75% debt ratio and Staff's estimate of Lake Region's business risk will maintain a "B+" bond rating is incorrect. The proxy bond rating would be lower than "B+" if Staff's business risk assessment is corrected to conform to the SUROEM. Therefore, Staff's proposed 75% debt ratio capital structure is not reasonable and not does represent a "B+" bond rating for Lake Region

Staff's SUROEM shows that a capital structure composed of 60% debt with a business

[123] **Lake Region Exhibit 5, Gorman Direct, at 6.**
[124] **Tr. 183-184.**
[125] ***Id.***
[126] **Lake Region Exhibit 5, Gorman Direct, at 6.**

profile score of "Satisfactory" would support a proxy bond rating of "B+."[127]. A utility with a total debt ratio of 60% falls at the cusp of the "Highly Leveraged" and "Aggressive" leverage category under the S&P matrix.[128] Hence, the Company's proposed capital structure with 60% debt is consistent with a "B+" bond rating and reasonably consistent with a "Highly Leveraged" utility financial profile. [129]

Staff's proposal to impute a capital structure of 75% debt is not reasonable based on the SUROEM parameters. S&P's methodologies do not prescribe the significant variations in the total debt ratio by Staff. As shown on Appendix 2, Schedule SA-3, page 4, for an "Aggressive" financial profile score (lower financial risk than "Highly Leveraged"), S&P only prescribes a 10 percentage point difference from 50% to 60%. At the "Highly Leveraged" category, the metrics suggest a debt ratio of 60% or greater. Staff's proposal to impute a capital structure of 15 basis points over the minimum 60% basis threshold for the "Highly Leveraged" capital structure based on S&P's financial metrics, is not consistent with the tolerance bands included in S&P's credit rating metrics. Indeed, the 15 basis point spread above the minimum debt level is significantly in excess of the range found in S&P's other financial risk categories. Staff has provided no basis or support for this large adjustment to the minimum "Highly Leveraged" category, and it should be disregarded.[130]

Staff's proposal to go from the start of the "Highly Leveraged" financial target of 60% debt up to 75% debt is clearly an extreme adjustment that is not reflective of S&P's published benchmarks nor does it produce a reasonable capital structure for Lake Region. This shows that

[127] **Staff Exhibit 1, Staff Report Cost of Service, Appendix 2, Schedule SA-1, page 3 of 7.**
[128] ***Id.* at 4.**
[129] **Lake Region Exhibit 5, Gorman Direct, at 7.**
[130] ***Id.* at 4-5.**

Staff's proposed hypothetical capital structure is not reasonable for Lake Region.[131]

7. Return on Equity

Staff estimated a return on equity using its target "B+" bond rating, and bond yield spreads from Treasuries to corporate bond yields of various maturities. Staff estimated a "B+" bond yield, using a current Treasury bond yield and "B+" to Treasury yield spread. The utility bond yield spreads to Treasuries were based on data from August, September and October of 2013. Staff found an appropriate return on equity by adding a 4 percentage point return on common equity risk premium adder to its "B+" bond yield of 9.87%. This produced a 13.89% return on equity. Lake Region reviewed Staff's return on equity methodology and finds it to be reasonable.

8. OPC Return on Equity Position

The OPC recommends that Lake Region's return on equity should be set at 8.5%. This is the return on equity awarded Lake Region in its last rate case. OPC provided no analysis that this return on equity is reasonably consistent with current market costs, nor is it reasonable and nor will it maintain Lake Region's financial integrity when the rates determined in this proceeding are in effect.[132] OPC's argument seems to only be that capital market costs have not increased since Lake Region's last rate case. However, there is no evidence that shows that the return on equity in the last rate case was based on Lake Region's current market cost of equity at that time. Indeed, Lake Region's last rate case was based on a global settlement, not specific factual findings. Therefore, the return on equity from the last case has not been proven to be reasonable and will support Lake Region's financial integrity and access to capital markets. As such, OPC's return on equity recommendation is not reasonable, is not supported by competent

[131] ***Id.*** **at 5-6.**
[132] **Tr. 198.**

and substantial evidence and should be rejected.

9. Staff's Alternative Return on Equity Position

In Staff's rebuttal testimony, Staff asserted that if the Commission adopts Lake Region's actual capital structure of 60% debt and 40% common equity, then the return on equity should be reduced to 11.93%, which would change its overall rate of return to 7.77%. Staff asserts that this would reflect an "Aggressive" financial profile score from S&P, rather than the "Highly Leveraged" financial profile score. Staff's alternative return on equity position should be rejected, because it is based on flawed logic and Staff's failure to follow its own SUROEM.

Staff's alternative return on equity ignores its own SUROEM. Staff has not supported its belief that a 60% debt ratio would put Lake Region into an improved financial risk profile score of "Aggressive" rather than "Highly Leveraged." Staff's report from S&P clearly shows that a 60% debt ratio is at the start of the "Highly Leveraged" and top end of the "Aggressive" financial business profile. There is simply no basis to accurately conclude that a 60% debt ratio could definitively fall into either category; however, it is reasonable to conclude that it could fall into both categories.

Further, because Staff ignored its own SUROEM in assigning a business risk profile score for Lake Region, its conclusions on financial risk do not allow for an accurate determination of a proxy bond rating. Even if Lake Region's financial risk has changed to a borderline between "Highly Leveraged" and "Aggressive," the clear finding based on Staff's SUROEM that its business risk should be "Satisfactory" and not "Strong," continues to support the finding that a proxy bond rating of "B+" is appropriate for Lake Region. This is based on Staff's own methodology, and S&P's clear uncontested credit rating financial metrics. S&P's bond rating criteria clearly indicate that a "Highly Leveraged" capital structure includes a 60% or

greater debt ratio.[133]

Further, there is additional support for using a "B+" proxy bond rating for Lake Region. Lake Region's actual cost of debt is consistent with a targeted "B+" bond rating. Lake Region witness Gorman testified, that the 5% minimum interest rate on the borrowing facility is consistent with a "B+" bond rating based on Staff's yield spreads included in Ms. Atkinson's testimony.[134] Lake Region's actual cost of debt is consistent with a "B+" bond rating category. Hence, a proper application of the SUROEM in observance of Lake Region's actual cost of borrowing, supports the use of a proxy bond rating of "B+" for establishing Lake Region's return on equity in this proceeding.

For all these reasons, if Staff's SUROEM is followed correctly, Lake Region's actual capital structure of 60% debt and 40% common equity is reasonable, its investment risk characteristics are proxied by a "B+" bond rating, and Staff's original recommended return on equity of 13.89% is fair and reasonable.

C. Legal Fees

Issue: Should the legal fees incurred during the test year (and the true-up timeframe[135]) for *Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer* be included in the calculation of rates for Lake Region?

If so, what is the appropriate mechanism for recovery of these costs?

Both Lake Region and Staff agree that the legal fees incurred by the Company during the test year and the true up period in defending this appeal were reasonable and should be included in the calculation of rates for Lake Region. Since the expenses are not a normal recurring cost that would otherwise be included in rates indefinitely, Staff has determined, and the Company

[133] ***Id.* at 3, 7.**
[134] **Tr. 156.**
[135] As legal fees is the only unresolved true-up issue, the Parties have agreed to include the true-up legal fee costs argument in the normal hearing briefs.

concurs, that a five-year amortization with a tracker to prevent over-recovery is the appropriate mechanism to recover these expenses.

OPC on the other hand, contends that the legal fees are a non-recurring expense and should not be included in the calculation of rates for Lake Region.

1. The Appeal

The issue involves a lawsuit filed against Lake Region by Shawnee Bend Development Company, LLC (SB Development) in 2009. SB Development claimed a breach of a 1998 contract with Lake Region and sought damages for alleged nonpayment of sums due for road crossings, a sewer trunk extension line and a water well SB Development constructed for the Villages, a real estate development at the Lake of the Ozarks.

Lake Region agreed that a payment was due the developer but, based on the contract terms, the Company disagreed with SB Development's interpretation of the contract and its calculation of amounts due. The matter was tried before Judge Kenneth Hayden in Camden County and the Circuit Court agreed with the Company's interpretation of the 1998 contract and two others between SB Development and the Company. The judgment of the trial court favored Lake Region. SB Development disputed the result claiming it was entitled to more compensation under the contracts and appealed to the Southern District Court of Appeals.[136]

At root was the interpretation of a Company tariff. The contracts under scrutiny were entered pursuant to Rule 14 of Lake Region's approved tariffs. SB Development took the position that any customers connected to the water well it constructed pursuant to the agreements, even though outside the boundaries of the geographical area agreed to by the parties in the contract, would qualify for the $1,000 connection payment contemplated in Rule 14 of the

[136] **Lake Region Exhibit 2, Summers Rebuttal, at 15.**

tariff. The trial court did not accept this interpretation of Rule 14 or the contracts. [137]

Contrary to the trial court's findings and conclusions, SB Development argued on appeal that Rule 14 of the Company's tariff required payment of well connection costs for customers outside the area which had been specifically described in the contract. The Company's position was that Rule 14 required such a payment only in accordance with the terms of the contract. The Southern District Court of Appeals agreed with SB Development and reversed the trial court.

Lake Region actively opposed SB Development's appeal of the judgment because the judgment rendered in the trial court was consistent with the Company's understanding of Rule 14's provisions and consistent with the series of contracts entered between the parties in accordance with Rule 14's requirements. The judgment as entered favored the Company. If the judgment went unopposed on appeal, chances for its reversal would be greater. If the judgment were reversed, the Company would incur additional costs and liability. The Company was justified in challenging SB Development on appeal to protect and preserve that judgment. Accordingly, the legal fees for pursuing the appeal were reasonably incurred and should be allowed.[138]

Staff's five-year amortization of the legal expenses with a tracker to prevent over-recovery is the appropriate mechanism to recover these expenses.

III. CONCLUSION

Lake Region has operated as an exemplary water and sewer company for over forty years. During its service history and the history of its regulation at this Commission, the availability fees at issue have clearly become a distinct matter of contractual rights between and among the owners or assignees of those fees, which include the original developer, and only one

[137] ***Id.* at 16.**
[138] **Lake Region Exhibit 2, Summers Rebuttal, at 16-17.**

shareholder in Lake Region. Those fees have no ongoing relevance to the utility. They are a matter of private contractual rights between the developer and lot owners. The developer had the ability to share or sell those rights to whomever it pleased.

The Commission lacks jurisdiction over the billing and collection of the availability fees described in the evidence in this case. The Commission has previously ordered that jurisdiction over those availability fees must be deferred, if exercised at all, following completion of a formal rulemaking process. The rulemaking is demanded by considerations of due process as guaranteed by constitutional law. Moreover, the proposals by Staff and OPC to apply the availability fees to Lake Region's revenue or its rate base are unreasonable and unjust. If either of those proposals is adopted, Lake Region's rates for service would not cover its cost of service. As a public utility, Lake Region is legally entitled to earn a reasonable return on investment, whatever its source, and the recovery in rates of its reasonable operating expenses.

The shareholders of a utility have the power to enter debt arrangements without approval of the Commission. Staff has inappropriately and unreasonably included a "shareholder loan" in formulating a recommended capital structure for the Company in this case. Default on the shareholder loan does not place the Company's assets or operations at risk. Lake Region's capital structure should be based on its actual capital structure and using that as the basis, an appropriate capital structure for the Company is 60% debt and 40% equity. The appropriate return on equity for Lake Region is 13.89%.

Lake Region acted justly in defending on appeal the trial court's favorable judgment entered in ***Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer.*** The legal fees it incurred on that appeal are reasonable expenses and should be allowed. The

Commission should approve a five-year amortization of those expenses with a tracker to prevent their over-recovery.

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 email, on this 21st day of March, 2014, to Kevin Thompson at kevin.thompson@psc.mo.gov; Tim Opitz at timothy.opitz@psc.mo.gov; General Counsel's Office at staffcounselservice@psc.mo.gov; Christina Baker at christina.baker@ded.mo.gov; and Office of Public Counsel at opcservice@ded.mo.gov.

/s/ Mark W. Comley

Lake Region Water & Sewer Company
Case No. 2013-0461

	Availability fees owned by Company	Infrastructure cost included in Original Rate Base	Availability fees Imputed to Company Revenue	Commission Position Consistent With Past Decisions
Lakesites Water and Sewer Company Case No. 17,954	Yes	Yes	Yes	Yes
Lakesites Water and Sewer Company WR-92-59	Yes	No	No	Yes
Ozark ShoresWater Company WR-99-193	Yes	Yes	Yes	Yes
Lakesites Water and Sewer Company WA-95-164	No	No	No	Yes
Lake Region Water and Sewer Company Case No. SR-2010-0110 & WR-2010-0111	No	No	No	Yes