

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

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

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

**LAKE REGION WATER & SEWER COMPANY'S INITIAL BRIEF**

**PART I**  
**ISSUES OTHER THAN AVAILABILITY FEES**

On October 7, 2009, Lake Region Water & Sewer Company ('Lake Region' or 'LRWS') submitted to the Commission tariff sheets designed to implement a general rate increase for water and sewer service provided to customers in its Missouri service area. The tariff sheets were designed to produce an aggregate annual water and sewer revenue increase of approximately \$331,223; (LRWS Ex. 4, Summers Direct, page 4) and had effective dates of November 6, 2009. Under Commission orders the effective date of the tariffs was suspended to September 6, 2010.

**Lake Region**

Lake Region possesses a certificate of convenience and necessity issued by the Commission on December 31, 1973, in PSC Case No. 17,975, to provide water and sewer service in Missouri. The Company is a water corporation pursuant to Section 386.020(52) RSMo (2009), a sewer corporation pursuant to Section 386.020(49) RSMo (2009), and subsequently a public utility within the meaning of 386.020(42) RSMo (2009); thereby subject to the jurisdiction of the Commission pursuant to Section 386.250(3) and (4) RSMo (2000) respectively.<sup>1</sup>

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<sup>1</sup> See Paragraph 1 of *Unanimous Stipulation of Undisputed Facts* filed jointly by the parties on March 16, 2010.

Lake Region provides water service to approximately 600 customers and sewer service to approximately 600 customers in its Shawnee Bend service area; and sewer service to approximately 140 customers in its Horseshoe Bend service area.<sup>2</sup> The supporting infrastructure for these customers includes two wells, an elevated water storage tank, sewage pumping stations and a wastewater treatment plant. Lake Region also provides sewer service to approximately 140 customers in the area known as Horseshoe Bend. The Company operates and maintains three sewage pump stations and four wastewater treatment plants in this area. The majority of Lake Region's customers are single family residential. However, approximately 40% of the Company's revenues are derived from commercial sewer customers located in the Horseshoe Bend area. (LRWS Ex. 4, Summers Direct, page 3).

### **Issues at Hearing**

The parties listed three issues for hearing before the Commission:

- 1. What is the appropriate level of executive management compensation to be included in LRWS's revenue requirement for setting LRWS's rates?**
- 2. Should charges for availability fees collected from owners of undeveloped lots in LRWS's service territory and billed and retained by an affiliate company be classified as LRWS revenue or applied against rate base?**
- 3. If the Commission finds charges for availability fees of undeveloped lots are not to be classified as LRWS revenue, or applied against rate base, then what costs should be identified and excluded from LRWS's cost of service?**

Briefing of the issues has been divided into several parts. In Part I of the briefing schedule, Lake Region confines its arguments to the appropriate level of executive management compensation to be included in its revenue requirement.

### **Executive Management Compensation**

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<sup>2</sup> See Paragraph 16 of *Unanimous Stipulation of Undisputed Facts*.

Lake Region is managed by an executive team. The Company uses a management approach developed by Dr. Vern Stump that is derived from his many years of experience in this industry. (LRWS Ex. 2, page 2). Dr. Stump, Robert Schwermann and Brian Schwermann make up the executive management group.

Dr. Stump is a professional engineer registered in the State of Missouri. He earned a PhD from the University of Missouri and has been actively involved in the water and sewer industries for the past 38 years.<sup>3</sup> Robert Schwermann graduated from the University of Kansas-Wichita in 1964 with a BS-BA degree and has been actively involved in the development and ongoing operations of utility systems for the past 45 years. Brian Schwermann graduated from Kansas State University with dual Bachelor of Science degrees in Finance and Accounting and has been involved in the water and sewer industries for the past 23 years. (Staff Ex. 7, Cost of Service Report, page 24)

Staff engaged in a comprehensive review of Lake Region's operations for purposes of its cost of service report in this matter. The review entailed on site visits to Lake Region's offices and interviews with its staff and management. Staff witness V. William Harris testified at length about the executive oversight provided by the management team. He correctly noted that Lake Region does not have any employees but rather contracts with the Camden County Public Water Supply District Number Four (Water District), to operate and manage the day-to-day operations of the Company as well as its affiliate, Ozark Shores Water Company. The Water District staff performs normal day-to-day administrative and operational functions for all three entities and consists of a General Manager (Mr. John Summers), two accountant administrative assistants and seven field operators. It is the executive management group that interacts with the District staff

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<sup>3</sup> As shown on Exhibit 1 of Dr. Stump's rebuttal testimony (LRWS Ex. 2) Dr. Stump has extensive experience in the ownership, management and operation of water and wastewater facilities.

and provides executive management oversight on a variety of advanced operational, technological and financial issues that are not generally expected to occur in the normal course of day-to-day operations. (Staff Ex. 9, Harris Surrebuttal, pages 1-2)

Mr. Harris also pointed out that the duties of the executive management group differ from those a board of directors might be expected to do. Among the types of activities Dr. Stump and Messrs. Schwermann perform which would not normally be the responsibilities of Board members are:

- Developing and implementing plans to install a new lift station and force main.
- Planning the implementation of a new automated meter reading system.
- Identifying solutions for water pressure issues.
- Arranging the financing of capital projects and on-going operations.
- Maintaining the accounting system, tax reporting requirements and overall records of the company.
- Maintaining ongoing relationships with lending institutions and outside auditors.
- Meeting and negotiating with representatives of the Company's largest customer to resolve a dispute regarding an inflow and infiltration (I&I) issue.
- Attending industry meetings and open discussions such as the Small Utility Meeting hosted by the MoPSC on December 14, 2009.
- Maintaining the utility operations in accordance with the Missouri Department of Natural Resources permits, rules and regulations.

(Staff Ex. 9, Harris Surrebuttal, page 3)

For purposes of developing his portion of the cost of service report, and subsequently preparing his written surrebuttal testimony, Mr. Harris personally observed the involvement of

the management team first-hand through interviews with the Schwermanns, Mr. Stump and John Summers at the Schwermanns' office in Overland Park, Kansas and at the Lake Region/Ozark Shores/Water District business office in Lake Ozark, Missouri. He toured the utility operations, held numerous discussions with Company personnel regarding the day-to-day operations of Lake Region and Ozark Shores and the inter-relationship between the Water District, reviewed data request responses, exchanged information through e-mail and reviewed other documents at the Company's offices to get an understanding of how the Company is managed. Specifically, he requested, and the Company supplied, information about the duties of the management team and how those duties differed from the responsibilities of the Lake Region and Ozark Shores general manager. (Staff Ex. 9, Harris Surrebuttal, page 7).

In this case Lake Region initially sought \$99,695 in management fees but during opening statements on March 29, 2010, its counsel advised the Commission that upon review of the Staff's audit results, and further opportunity to examine the issue, Lake Region became aware that this amount should be split between Lake Region and Ozark Shores. Lake Region asserts that the appropriate amount of management fees and expenses to which it is entitled in this matter is \$49,847.00.

Staff's witnesses support a lesser amount. Staff recommends that \$27,901 is the proper cost to include in the Company's cost of service for executive management oversight.

The Office of Public Counsel (OPC) sponsored the testimony of Mr. Ted Robertson. He discards both Lake Region's and Staff's recommendations for management fees. He contends that Lake Region is entitled to \$600 annually for executive management. Mr. Robertson's recommended level of management fees for the Company should be rejected with celerity.

Mr. Robertson's recommendation of what Lake Region should receive in management fees is based upon his opinion that Lake Region's management group does nothing more than what an ordinary board of directors would do for a company of this size. (OPC Ex.3, Robertson Rebuttal, page 4). It also appears that Mr. Robertson believes this amount is appropriate because the management team members 1) are not employees or executives of Lake Region. (OPC Ex. 3, Robertson Rebuttal, pages 5-6) (Tr. 184); and 2) serve the Company without the formality of a written management agreement. (Tr.185) He admits that he conducted no interviews with the executive management team and did not visit the offices of the utility or the offices of the members of the executive group. Nonetheless, he is content in an unsupportable belief that the management of the Company has been exclusively the task of Mr. Summers, its General Manager. (Tr. 183). He does concede that the Company "probably is well managed." (Tr. 183).

Mr. Robertson's classification of the executive skills of Dr. Stump, Robert Schwermann and Brian Schwermann as merely the work of a board of directors cannot stand against 1) the credentials of these individuals, their level of experience and activity in the economic and regulatory life of Lake Region; and 2) the findings and conclusions of Staff witness Harris which were made after lengthy onsite visits and interviews that verified the management group's considerable services to the Company. Furthermore, the absence of a written management agreement between the management group and the Company, or the absence of an employer-employee relationship with the group members, does not change the indisputable fact that the executive management group performs exactly as reported in the Staff Cost of Service report.

Most importantly, as Staff witness Harris correctly observes in his surrebuttal testimony,

Lake Region accounts for their services the same way that Aqua Missouri, Inc. and Roarke Water and Sewer, Inc. account for their "management fees" - as an

outside service rendered by other than an employee (much like legal services or engineering services).

(Staff Ex. 9, Harris Surrebuttal, page 6).

In his rebuttal testimony, Dr. Stump told the Commission about a review Lake Region made of the 2008 Annual Reports for Aqua Missouri, Aqua RU, Inc. and U S Water Company. He also attached a schedule to his rebuttal testimony which summarized the results. He testified:

The amounts recorded for salary and benefits for top management and/or management fees range from \$31,562 to \$87,200 with the average being \$56,826. The amounts as a percentage of revenue range from 6% to 12% with the average being 8%. I have also compared these amounts to the amount of the annual Commission Assessment. For the fiscal year beginning July 1, 2009 the amount of this assessment was \$56,741, or approximately 8% of the Company's revenues for 2008.

(LRWS Ex. 2, Stump Rebuttal, page 3)

Lake Region is entitled to be treated comparably to other water and sewer utilities of similar characteristics such as customer base and revenue. There is more than adequate evidence before the Commission to support a conclusion that \$49,847 is the proper amount to include in the Company's cost of service for executive management oversight .

Respectfully submitted,

/s/ Mark W. Comley

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**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the above and foregoing document was sent via email, on this 28<sup>th</sup> day of May, 2010, to:

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/s/ Mark W. Comley