BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Water Rate Increase Request of Hillcrest Utility Operating Company, Inc.	))))	Case No. WR-2016-0064

HILLCREST'S REPLY BRIEF

COMES NOW Hillcrest Utility Operating Company, Inc. (Hillcrest or Company), and provides this reply to the Initial Briefs of the Missouri Public Service Commission (Commission) Staff (Staff) and the Office of the Public Counsel (OPC).

The fact that Hillcrest does not respond to each and every statement contained in those briefs should not be taken as acquiescence and the matters not addressed. Rather, Hillcrest's decision simply reflects the fact that those matters were adequately addressed in its Initial Brief.

TABLE OF CONTENTS

1. Introduction

It is not surprising that the Staff and OPC have different opinions as to the issues being tried before the Commission. This is not the first rate case, nor the last, where the Commission will be asked to review and consider matters of disagreement between the Company and these entities.

What is surprising is the continued and uncalled for personal attack on Hillcrest's witness. All Mr. Cox has done in the several years that he has now interacted with the Commission's personnel is perform as he has represented. He has negotiated and facilitated the purchase of small water and sewer companies needing substantial investment because of existing environmental violations, he has facilitated temporary repairs in certain instances to allow Missourians to have basic access to water and sewer services during the pendency of Commission proceedings, he has obtained financing to perform necessary permanent repairs at the cost of money he suggested was necessary, he has completed the construction he promised at a cost less than his estimates, and he has, in this instance, proposed rates generally consistent with the estimates that were provided before the water and sewer systems were purchased or any construction performed at Hillcrest.

Additionally, Mr. Cox has interacted with the Department of Natural Resources and the Missouri Attorney General to reach agreements to remedy violations committed by other operators, has completed the actions to which he has committed, and received the blessing of the DNR and AG as to such completion.

Staff's Initial Brief refers to Hillcrest as "*well-functioning water and sewer utility*." (Stf. Brf., p. 25) This is something it most certainly was not before Hillcrest's and Mr. Cox's involvement.

With seemingly full knowledge of these facts, the OPC has chosen to ignore actual, proven performance and, instead, attempted to drag Mr. Cox through the mud of his past bankruptcy in an attempt to assail his "credibility." The only "credibility" issue that seems to be in play is Hillcrest's allegation that the financing Hillcrest is utilizing is the only financing that was available. In spite of OPC's position, it has yet to come forward with what would have been a much better and productive attack on Mr. Cox's "credibility" – evidence of available financing at a lower rate. No such evidence of this has been produced because none exists.

It is unclear what OPC's policy goal is in regard to these attacks on Mr. Cox. It is possible that OPC believes that anyone having suffered through a bankruptcy should not be allowed to participate in the regulatory process. This counsel is unaware of this ever having been a disqualifying (or even a relevant) factor in the past for a utility company officer.

It is also possible that it is OPC's desire to destroy an active participant in the small water and sewer infrastructure segment of the Missouri utility industry. In numerous instances, the Commission has been presented with testimony and experienced that there is an extremely limited number of persons or entities that have the desire, skills, and wherewithal to address what is a known problem in Missouri. It is unclear how the public interest in Missouri will be served by eliminating a participant in

this field that now has shown it can successfully bring such systems into compliance with drinking water and discharge requirements.

Moreover, what OPC has provided in evidence is far less significant than what it claims. OPC has established that Mr. Cox went through a bankruptcy and received a discharge from the bankruptcy court. This process, while not desirable and not something that Mr. Cox is proud of, is a lawful practice, established by federal law and recognized by the State of Missouri. In his pre-filed testimony, Mr. Cox explained at the background of this circumstance, as well as what he learned and how he has grown from this circumstance. (Hillcrest Exh. 2, Cox Reb., pp. 15-17)

It has also been proven that after the second chance provided by his bankruptcy, Mr. Cox has made himself into a productive member of society, who is able to care for his family, while bringing necessary water and sewer services to those in great need of such services. This seems to be absolutely consistent with the purpose of the bankruptcy process.

Beyond this, OPC merely has presented allegations based on erroneous assumptions. For example, the only evidence of Mr. Cox's assets as of the date the bankruptcy filings were made is the bankruptcy documents themselves. At the hearing, OPC referenced the Articles of Organization for First Round CSWR, LLC, and the Articles of Incorporation for Central States Water Resources, Inc. Nothing about the filing of articles of incorporation or articles of organization creates ownership. Neither a

limited liability company nor a corporation is required to have "owners" at its creation. That is a separate process that can occur much later.[1]

Additionally, neither of these documents reference Mr. Cox in any capacity (both of which are available publicly with the Missouri Secretary of State (https://bsd.sos.mo.gov/Common/CorrespondenceItemViewHandler.ashx?IsTIFF=true&filedDocumentid=10217841&version=1 and https://bsd.sos.mo.gov/Common/CorrespondenceItemViewHandler.ashx?IsTIFF=true&filedDocumentid=10222114&version=1). They reference persons that have been identified as prior owners of these entities. At the entities' creation, Mr. Cox had no ownership interest - consistent with his bankruptcy filing.

There is no evidence that Mr. Cox was employed, had an agreement to be employed, or was receiving a salary at the time of his bankruptcy filing (because he was not employed until March).[2]

Lastly, Mr. Cox's bankruptcy counsel was advised of Mr. Cox's then status before filing the petition. (Tr. 86-87) Entities were not listed because Mr. Cox did not own them. (Tr. 87) New employment was not listed because Mr. Cox was not employed and had no agreement to be employed.

While a baseless allegation has been made that Mr. Cox filed schedules and/or other documents in his personal bankruptcy proceeding that were inaccurate, false or

[1] Mr. Cox did not own any share of First Round CSWR, LLC, in January of 2014. (Tr. 85) Mr. Cox acquired an ownership interest in Central States Water Resources, Inc. later. (Tr. 47)

[2] While it does show dollars received by First Round CSWR, LLC in January 2014, there is no description of who arranged for those payments, what agreements and conditions were associated with those payments, and what obligations First Round CSWR had in regard to those payments.

untrue, the OPC set forth this allegation without any facts to support this claim other than pure conjecture that Mr. Cox had some type of agreement with the investors in First Round CSWR, LLC and Central States Water Resources, Inc. prior to his filings in his personal bankruptcy. It appears that the OPC's argument is that if an individual has reason to believe that he or she may have a business plan or idea that will generate interest from investors or that he or she has discussed such a business plan or idea with investors who show interest, that such individual must add this potential, future business endeavor on his or her schedules in a bankruptcy proceeding regardless if the individual has actually obtained an ownership interest or received something of value related to an actual endeavor or entity that would pursue the endeavor. However, OPC provided no evidence to demonstrate that Mr. Cox owned an interest in First Round CSWR, LLC or Central States Water Resources, Inc. or any other entity, property or asset that was not set forth on his schedules in the bankruptcy proceeding at the time he filed his schedules with the Bankruptcy Court and OPC provided no legal authority to support its contention that a potential, future interest in an endeavor or entity should be listed on an individual's schedules in a bankruptcy proceeding. To the contrary, after a due and diligent search, there appears to be no such authority on this issue.

The fact of the matter remains that Mr. Cox completed his schedules and other filings in his personal bankruptcy appropriately and there is nothing in the record to contradict this fact. His potential, future ownership interest in First Round CSWR LLC and Central States Water Resources, Inc. was not disclosed in the schedules in his personal bankruptcy in that it would not be proper to make such a disclosure.

OPC's evidence of alleged impropriety is so slim that it appears the goal is not to provide the Commission with information necessary for it to reach a fair decision as to just and reasonable rates, but rather to threaten Mr. Cox and destroy his reputation (and, apparently, by extension, to destroy a "*well-functioning water and sewer utility*") by the use of innuendo. The Commission should not validate this process.

OPC asks this Commission to look behind an otherwise valid Federal Bankruptcy Court order and reach a different conclusion than the Federal Bankruptcy Court. There is no basis in fact or law for the Commission to do so and no issue in this case that would require the Commission to do so.

2. Corporate Allocation

What is the appropriate corporate allocation percentage to apply to corporate costs?

Hillcrest has proposed to allocate fourteen percent (14%) of its corporate costs to Hillcrest for ratemaking purposes. Staff has used the same allocation. (Stf. Ini. Brf., p. 16)

OPC attacks the 14% figure by arguing that it is based on "estimated, future costs." (OPC Ini. Brf., p. 3) This allocation is not based on future "costs," but instead an appropriate allocation based on the acquisitions that have been made, or are in the process. The bigger problem with OPC's argument is that basing the allocation on either current customers or time sheets would result in a higher allocation to Hillcrest. Current customer numbers support a higher allocation of costs to Hillcrest (28.6%) (Hillcrest Ini. Brf., p. 5) Additionally, but for OPC's refusal to add any time associated

with utility administration, engineering, hiring of contractors, interaction with Commission personnel, or interaction in regard to Department of Natural Resources matters, OPC's method would result in an allocation of as high as 33%. (Hillcrest Ini. Brf., pp. 5-7)

The allocation supported by Hillcrest and Staff is reasonable and beneficial to the Hillcrest customers.

3. **Payroll**

OPC bases its salary recommendation in large part upon a review of small water and sewer utilities performed by OPC witness Roth. (OPC Ini. Brf., p. 5) It suggests, based on this review, that "OPC's proposal is more in line with those hourly rates and job titles seen amongst similarly-situated small water and sewer utilities." (*Id.* at pp. 5-6)

First, it must be considered that Hillcrest's parent is currently responsible for at least 3 utility companies that between them operate 4 sewer systems and 2 water systems. (Tr. 200) These utilities are actively raising funds, working with the DNR and AG to solve environmental problems, bidding and contracting for construction, managing construction projects, and interacting with this Commission as to rate issues. Hillcrest does not believe any of the utilities cited by OPC witness Roth are performing similar functions, and certainly not on the behalf of several utilities, as is being done by Hillcrest's parent.

The list of utilities reviewed by Ms. Roth was found at page 5 and Schedule KNR-3 HC of her Direct Testimony.[3] (OPC Exh. 1, Roth Dir., p. 5) A review of the utilities

[3] The hourly wage figures were identified as Highly Confidential, but not the identity of the utilities.

examined by Ms. Roth reveals a group of utilities which have very little in common with Hillcrest's parent, or are in a condition the Commission would not want to emulate –

- Lincoln County Sewer & Water, LLC – One regulated entity, with all payroll costs allocated to that entity; (Tr. 200-201)
- Ozark International, Inc. -- Ozark International's "Moore Bend" property is currently the subject of an OPC complaint (Tr. 201) alleging bacterial contamination; failure to adequately chlorinate, and lack of remedial efforts concerning lead pipe corrosion. (Complaint, Case No. WC-2016-0252) Further, in 2015, the Staff submitted a recommendation (WO-2015-0077) in regard to a proposed Ozark International acquisition stating that it was "unable to submit a position recommendation" based upon several concerns:

  > . . . customer complaints about quality of service as well as complaints about inadequate response from the utility when the customers call the utility with a question or a problem; some of the affiliates' poor handling of matters with previous cases before the Commission involving sale cases similar to this current case as well as rate cases; and issues involving DNR regulations sometimes resulting in water boil orders and notices of violations. There are 10 matters showing in the Commission's EFIS's system related to customer service matters with Mr. Brower's regulated utilities and active matters under review and compliance with the Department of Natural Resources.

- Lake Region Water & Sewer Company - 100% of the general manager's time would be allocated to Lake Region. (Tr. 202)
- Terre Du Lac Utilities Corporation - 100% of the general manager's time would be allocated to Terre Du Lac. (Tr. 202) Further, the DNR enforcement list reflects that there are issues with radionuclides in the drinking water. (Tr. 66)

- Raytown Water Company -- 100% of the general manager's time would be allocated to Raytown Water. (Tr. 202) and,
- Village Greens Water Company -- 100% of the general manager's time would be allocated to Village Greens and Village Greens is very small – around 71 customers. (Tr. 203)

Moreover, Ms. Roth had no knowledge as to whether any of these entities are actively raising capital and building water and sewer plants. (Tr. 203)

The OPC comparison does not involve "similarly-situated small water and sewer utilities," as it claims. Hillcrest's parent is addressing and solving a more complex set of issues, requiring more significant capital, over a larger customer base than the entities cited by OPC.

4. **Rate of Return**

What is the appropriate allowed debt rate to apply to the debt in the ratemaking capital structure?

Hillcrest's actual debt cost (14%) should be used. To do otherwise, is to assume financing that just is not available to Hillcrest for the purpose of completing the necessary improvements. (Hillcrest Exh. 2, Cox Reb., p. 22)

Staff acknowledges that the cost of debt is usually "based on the costs a utility MUST pay in the course of doing business to secure financing." (Stf. Ini. Brf., p. 14) However, Staff argues that the Commission should not use the actual debt here because it believes the debt is not consistent with that of a "traditional passive third-party investor." (*Id.* at p. 13) This assumes that a "traditional passive third-party debt

investor" exists for this transaction. Staff has not identified an available source for such an arrangement and Hillcrest has demonstrated that no such financing exists.

OPC also fails to identify any such source. OPC does suggest that all that a utility owner needing a million dollars for construction need do is not have a bankruptcy in his or her past and offer a personal guarantee. (OPC Ini. Brf., p 10) It is absurd to take the position that a loan of $1M for a failing water and sewer utility with minimal revenues, minimal assets, and known environmental violations and liability, could be had in this way. This approach gets even more impossible in this situation if one adds the necessary millions of dollars necessary to correct problems at Raccoon Creek and Indian Hills.

Further, even if it were possible, it unclear from a policy perspective why OPC would want to link the fate of public water and sewer systems to the risks associated with unregulated, personal finance decisions. The Missouri Public Service Commission statutes protect the public and the utility by requiring authority be obtained for certain decisions and imposing consequences where it is not because it is in the public interest to do so. What OPC proposes would essentially evade these protections by intentionally co-mingling public utility and personal finances.

Staff also suggests that the actual debt cost should be ignored by the Commission because "Mr. Cox never revisited the rate following the new investors' acquisition." (Stf. Ini. Brf., p. 12) This is based on a provision in the acquisition case that indicated that Hillcrest must show "in subsequent rate cases" that "it sought the least cost option available to it as to the proposed financing and ownership structure." (*Id.*)

Prior to filing its first asset acquisition and financing case, Central States/Hillcrest met with over fifty specialized infrastructure institutional investors, private equity investors, and investment bankers, along with traditional banks, in an attempt to create a program to build water and wastewater improvements to support distressed small water and wastewater utilities in Missouri. (Hillcrest Exh. 1, Cox Dir., p. 24) The capital structure Hillcrest is utilizing is the only structure that could be found. (*Id.*) Moreover, this is the same structure Hillcrest presented to Commission in its acquisition and financing application. (*Id.*)

Mr. Cox has continued to approach banks and other sources, as the business continues to build and since the Glarners became involved. (Hillcrest Exh. 1, Cox Dir., p. 27; Tr. 63, 107, 109-110) He has met with multiple capital groups to include McQuarry Capital, American Infrastructure Holdings, and Sohitiz Capital, in an attempt to find cheaper financing. (Tr. 632) However, so far, these efforts have continued to be rejected. (Hillcrest Exh. 1, Cox Dir., p. 27) He has also continued to try to attract other financing from multiple other investment banks and mezzanine finance groups and have been unsuccessful. (*Id.*)

Hillcrest believes that its continuing attempts to attract other financing constitute attempts to obtain the least cost option available to it. Further, without other options, it is unclear why "revisiting" a rate present in a existing and approved financing agreement would be required or what it would accomplish. This is especially the case as when the new owners became involved, the risk associated with this endeavor had not changed – no improvements had been made. (Tr. 106)

Hillcrest demonstrated during the acquisition case that no traditional "third party" financing exists. Additionally, Hillcrest's parent continues to provide information concerning more recent attempts to obtain financing with each subsequent acquisition.

5. **Rate Design**

Should a rate increase be implemented all at once or phased-in over time?

Hillcrest discussed in its Initial Brief the issue concerning the Commission's lack of authority to order a phase-in of rates for a water and sewer utility. The Commission has specific authority to order a phase-in for electric utilities. Section 393.155, RSMo, ("If, after hearing, the commission determines that any electrical corporation should be allowed a total increase in revenue that is primarily due to an unusually large increase in the corporation's rate base, the commission, in its discretion, need not allow the full amount of such increase to take effect at one time, but may instead phase-in such increase over a reasonable number of years.")

When a statute mentions something specifically, it in turn implies the exclusion of something else. *Harrison v. MFA Mutual Insurance Corporation*, 607 S.W.2d 137, 146 (Mo. banc 1980); *see also Bridges v. Van Enterprises*, 992 S.W.2d 322, 325 (Mo. App. SD. 1999) (Citing *Brown v. Morris*, 290 S.W.2d 160 (Mo Banc 1956)). Section 393.155.1, RSMo does not mention water, gas, or sewer utilities.

OPC suggests that authority for a phase-in comes from Section 386.270, RSMo, which states as follows:

> All rates, tolls, charges, schedules and joint rates fixed by the commission shall be in force and shall be prima facie lawful and all regulations, practices and services prescribed by the commission shall be in force and

> shall be prima facie lawful and reasonable until found otherwise in a suit brought for that purpose pursuant to the provisions of this chapter.

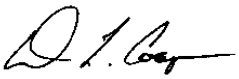
This statute has generally been viewed as a statutory establishment of the "filed rate doctrine." It is not an authorizing statute, but rather describes the effect of Commission decisions. Section 386.270, RSMo is not applicable to this situation

Staff suggests that Section 393.146, RSMo provides "implicit authority" for the Commission to order a phase-in for water and sewer utilities. Section 393.146, RSMo concerns the acquisition of a "small water" or "Small sewer" corporation by a "capable public utility" ("a public utility that regularly provides the same type of service as a small water corporation or a small sewer corporation to more than eight thousand customer connections"). It is inapplicable to the situation at hand. Further, subsection 11, cited by Staff, merely provides authority for a utility that would otherwise not qualify for the small company rate case to use that procedure. It does not provide implicit authority for the Commission to provide a utility less than would otherwise be a just and reasonable rate and, if it did, it would be confiscatory and constitute an unconstitutional "taking."

WHEREFORE, Hillcrest respectfully requests that the Commission consider this

Reply Brief and, thereafter, issue such order as it shall find to be reasonable and just.

Respectfully submitted,



Dean L. Cooper MBE# 36592
BRYDON, SWEARENGEN & ENGLAND P.C.
312 East Capitol Avenue
P.O. Box 456
Jefferson City, MO 65102-0456
Telephone: (573) 635-7166
dcooper@brydonlaw.com

ATTORNEYS FOR HILLCREST UTILITY OPERATING COMPANY, INC.

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail on June 15, 2016, to counsel for the parties to Case No. WR-2016-0064.