

<b>Exhibit No.:</b>	
<b>Issue(s):</b>	Availability Fees/ Capital Structure & Return on Equity
<b>Witness/Type of Exhibit:</b>	Robertson/Surrebuttal
<b>Sponsoring Party:</b>	Public Counsel
<b>Case No.:</b>	WR-2013-0461

**SURREBUTTAL TESTIMONY**

**OF**

**TED ROBERTSON**

Submitted on Behalf of the Office of the Public Counsel


**LAKE REGION WATER & SEWER COMPANY**

**CASE NO. WR-2013-0461**


January 31, 2014

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

**STATE OF MISSOURI     )**  
                                     **)     ss**  
**COUNTY OF COLE     )**

  
Ted Robertson, C.P.A.  
Chief Public Utility Accountant

A circular notary seal for the State of Missouri. The outer ring contains the text "NOTARY PUBLIC" at the top and "STATE OF MISSOURI" at the bottom, separated by two stars. The center of the seal contains the words "NOTARY" and "SEAL" stacked vertically.

  
Jerene A. Buckman  
Notary Public

My Commission expires August 23, 2017.

## TABLE OF CONTENTS

Testimony	Page
Introduction	1
Purpose of Testimony	1
Availability Fees	1
Capital Structure and Return On Equity	8

LAKE REGION WATER AND SEWER COMPANY  
CASE NO. WR-2013-0461

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of this Rebuttal Testimony is to update the Commission regarding Public Counsel's position on the ratemaking treatment for availability fees and to address Public Counsel's position regarding the Company and MPSC Staff capital structure and return on equity recommendations.

Q. DOES PUBLIC COUNSEL NOW HAVE A SPECIFIC RECOMMENDATION AS TO THE AMOUNT OF CONTRIBUTIONS IN AID OF CONSTRUCTION ("CIAC") TO INCLUDE AS AN OFFSET FOR EACH OF THE UTILITY SYSTEMS?

A. Yes. Company has consistently refused to provide Public Counsel and the Commission with the information that would allow OPC to identify accurately, without estimation, the alleged contributions in aid of constructions (i.e., donated

investment) associated with the individual utility's plant-in-service or the actual availability fees billed and collected by either the utility, the utility shareholders or the developer of the systems. However, Company's refusal to provide the actual data has not prevented OPC from preparing an analysis for the Commission that shows the estimated amounts for availability fees collected within the Shawnee Bend Water and Sewer operations jurisdiction in comparison to the Company's and the MPSC Staff's stated investment donated by the original developers.

Q. PLEASE CONTINUE.

A. Attached as Schedule TJR-1 is an analysis of availability fee amounts billed and/or collected by the utility and/or its shareholders for the calendar years 1995 through 2013. As noted on Schedule TJR-1 some of the amounts shown are estimates based on information relied upon in the Company's original Shawnee Bend certificate case, Case No. WA-95-164, along with exhibits and affidavits provided in the Company's last general rate increase cases, Case Nos. SR-2010-0110 and WR-2010-0111.

What the analysis shows is that during the referenced time-period approximately \$6.6 million of availability fees has been billed and/or collected by the utility and/or its owners. Assuming that the fees are assigned 40%/60% between the water and sewer systems (the actual yearly fees are 40% water and 60% sewer based on monthly charges of \$10 for water and \$15 for sewer), as of the end of calendar year

2013 \$2,639,900 of the \$6.6 million are water-related fees and \$3,959,849 are sewer-related fees.

Q HOW DO THE AVAILABILITY FEES SHOWN IN THE ANALYSIS COMPARE TO THE COST OF DONATED INVESTMENT OF THE ORIGINAL DEVELOPERS?

A Comparison of the availability fees to developer donated investment first requires the aggregation of the Utility's early investment amounts. Attached to this testimony are two schedules which represent the plant investment of the utility for the periods that the development was being built-out and subsequent years. Schedule TJR-2 shows the costs pulled from the MPSC Annual Reports while TJR-3 shows the costs from the MPSC Staff workpapers in the Company's current and last general rate increase cases.

Q. WHAT IS THE AMOUNT OF PLANT INVESTMENT DONATED BY THE DEVELOPERS AS SHOWN IN THE MPSC ANNUAL REPORTS?

A. Schedule TJR-2 shows CIAC of \$2,261,750 for the Shawnee Bend water system and \$2,934,203 for the Shawnee Bend sewer system at the end of calendar year 2002 (the sewer system investment costs as shown in the MPSC Annual Reports is an aggregated amount which includes costs associated with both the Shawnee Bend and the Horseshoe Bend sewer systems; however, no CIAC is shown for the Horseshoe Bend sewer system prior to development of the Shawnee Bend sewer system so CIAC, if any, for the Horseshoe Bend sewer system would likely be immaterial).

1  
2 Q. WHY DID YOU CHOOSE CALENDAR YEAR 2002 TO DETERMINE THE  
3 DEVELOPER'S DONATED INVESTMENT?

4 A. In calendar year 2002 the utility booked a large entry to its plant-in-service and  
5 CIAC presumably to account for the finalization of the development costs. This is  
6 evident because up until the current owners took control of the utility, in late 2004  
7 (see attached Timeline, Schedule TJR-4), the subsequent years investment  
8 increased only slightly on a year over year basis and the CIAC balances are shown  
9 as decreasing.

10  
11 Q. WHAT DOES THE COMPARISON OF THE AVAILABILITY FEES IN YOUR  
12 ANALYSIS WITH DEVELOPER DONATED INVESTMENT IN THE MPSC  
13 ANNUAL REPORTS SHOW?

14 A. Comparing the \$2,639,900 of water availability fees to the CIAC of \$2,261,750 for  
15 the Shawnee Bend water system shows that the availability fees exceed the  
16 developer donated investment by approximately \$378,150 (i.e., \$2,639,900 less  
17 \$2,261,750). While comparing the \$3,959,849 of sewer availability fees to the  
18 CIAC of \$2,934,203 for the Shawnee Bend sewer system shows that those  
19 availability fees exceed the developer donated investment by approximately  
20 \$1,025,646 (i.e., \$3,959,849 less \$2,934,203).

21  
22 In both operations the amount of availability fees presumed collected have far  
23 exceeded the donated investment of the developer. This, along with the fact that

1 availability fees will most likely continue in the future, indicates that these fees were  
2 designed to recover not only the original cost of the utility investment but also any  
3 other additional treatment capacity or other water and sewer infrastructure, such as  
4 line extensions and pumping stations, etc., required to build a state of the art  
5 system to serve customers at the time they are ready to take service. Therefore,  
6 Public Counsel recommends that the excess availability fees be included in the  
7 instant case rate bases as additional CIAC paid by lot owners within the jurisdiction  
8 of the Utility.  
9

10 Q. DOES THE EXCESS OF AVAILABILITY FEES OVER DEVELOPER DONATED  
11 INVESTMENT SHOWN IN THE PRIOR Q&A DIFFER MATERIALLY FROM A  
12 COMPARISON OF THE AVAILABILITY FEES WITH THE DEVELOPER  
13 DONATED INVESTMENT AS SHOWN IN THE MPSC STAFF WORKPAPERS?

14 A. There is a material difference for the sewer system comparison, but not for the  
15 water system. For example, comparing the \$2,639,900 of water availability fees to  
16 the MPSC Staff CIAC of \$2,308,570 for the Shawnee Bend water system shows  
17 that the availability fees exceed the developer donated investment by  
18 approximately \$331,330 (i.e., \$2,639,900 less \$2,308,570). The \$331,330 is only  
19 \$46,820 less than the \$378,150 shown in the comparison of availability fees and  
20 the developer donated investment booked in the MPSC Annual Reports. Whereas,  
21 a comparison of the \$3,959,849 of sewer availability fees to the MPSC Staff CIAC  
22 of \$3,254,006 (at calendar year end 2005) for the Shawnee Bend sewer system  
23 shows that the availability fees exceed the developer donated investment by



1 approximately \$705,843 (i.e., \$3,959,849 less \$3,254,006). The \$705,843 is  
2 \$319,803 less than the \$1,025,646 shown in the comparison of availability fees and  
3 developer donated investment booked in the MPSC Annual Reports. This  
4 difference of \$319,803 is a material change from the prior comparison, but the  
5 excess availability fees of \$705,843 is still a very significant amount.  
6

7 Q. WHY DID YOU COMPARE SEWER SYSTEM AVAILABILITY FEES WITH  
8 DEVELOPER DONATED SEWER SYSTEM INVESTMENT AT THE END OF  
9 CALENDAR YEAR 2005 RATHER THAN THE CALENDAR YEAR 2002 UTILIZED  
10 IN THE WATER SYSTEM AND THE MPSC ANNUAL REPORTS  
11 COMPARISONS?

12 A. The MPSC Staff sewer system workpapers shows the booking of the developer's  
13 costs and contributions over several years with the large calendar year 2002  
14 booking entry discussed earlier as occurring in calendar year 2005. Public Counsel  
15 believes the MPSC Staff's workpaper to be incorrect since the current owners, who  
16 were not the developers of the system, obtained control of the utility in late 2004.  
17 However, since the CIAC amount shown at the end of calendar year 2005 includes  
18 the large booking entry that actually occurred in calendar year 2002 and the  
19 balance was not increasing Public Counsel believes it includes all of the developers  
20 donated investment (and likely other additional CIAC provided by ratepayers or the  
21 current shareholders subsequent to the developers relinquishing control of the  
22 utility resulting in the \$705,843 actually being an understatement of the total  
23 excess).

1  
2 Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S RECOMMENDATION FOR  
3 THIS ISSUE.

4 A. Public Counsel prepared an analysis of the estimated availability fees billed and/or  
5 collected by the utility based on available documentation. The Company's, and its  
6 shareholders, consistent refusal to provide actual data on availability fees billed and  
7 collected required that Public Counsel develop the estimates with the information  
8 and data that was available. Public Counsel does not present its estimates of  
9 availability fees billed and/or collected to the Commission as actual amounts as  
10 only the Utility and its shareholders have access to that information, but Public  
11 Counsel does believe that based on the information available to it the estimates are  
12 a reasonable approximation of the availability fees billed and/or collected and the  
13 comparisons with developer donated investment result in reasonable  
14 approximations of excess monies collected by the developers, the Utility and/or the  
15 Utility's shareholders over and above the cost of the developers donated  
16 investment. Thus, Public Counsel recommends that the rate bases of the water and  
17 sewer systems be further reduced by the excess availability fees shown. In order  
18 to be conservative, Public Counsel recommends that the water system rate base  
19 be reduced by the inclusion of additional CIAC in the amount of \$331,330 ,and that  
20 the sewer system rate base be reduced by the inclusion of additional CIAC in the  
21 amount of \$705,843.  
22  
23

1 IV. CAPITAL STRUCTURE AND RETURN ON EQUITY

2 Q. DOES PUBLIC COUNSEL HAVE CONCERNS WITH THE COMPANY AND  
3 MPSC STAFF CAPITAL STRUCTURE AND RETURN ON EQUITY  
4 RECOMMENDATIONS?

5 A. Yes. The Company's original recommendation incorporates a capital structure of  
6 59.90% debt and 40.10% equity% that is based on its proposed net rate base along  
7 with a common equity return of 11.07% and a debt cost of 5.00% for the loan  
8 authorized in its recent financing Case No. WF-2013-0118. Whereas, the MPSC  
9 Staff's recommendation incorporates a hypothetical capital structure of 75.00%  
10 debt and 25.00% equity with a common equity return of 13.89% and a debt cost of  
11 5.00%. The MPSC Staff utilized a hypothetical capital structure due to the fact that  
12 its analysis determined the capital structure of the Company consists of 100.00%  
13 debt based on a comparison of the MPSC Staff 's recommended net rate base  
14 versus the aforementioned WF-2013-0118 loan plus another loan the shareholders  
15 utilized to finance the original acquisition of the utility. Thus, according to the  
16 MPSC Staff, because there are practical limitations on estimating the cost of  
17 equity at such extreme levels of leverage the MPSC Staff decided to cap the  
18 leverage ratio at 75% debt.

19  
20 Q. HAS THE COMPANY SUBSEQUENTLY MODIFIED ITS RETURN ON EQUITY  
21 RECOMMENDATION?

22 A. Yes. Though the Company does not appear to have moved off of its proposed  
23 60% debt and 40% common equity ratio capital structure it now believes that the

1 MPSC Staff recommended return on equity of 13.89% is more appropriate or  
2 "reasonable" than the 11.07% return on equity it originally proposed. Beginning on  
3 page 2, line 21, of the Rebuttal Testimony of Company witness, Mr. Michael P.  
4 Gorman, it states:

5  
6 I find Staff's estimated return on equity to be generally consistent with  
7 the Company's proposed capital structure mix, and is reasonable in  
8 light of the Company's intention to use a verifiable capital structure.  
9  
10

11 Q. DO YOU AGREE WITH COMPANY THAT ITS ACTUAL CAPITAL STRUCTURE  
12 SHOULD BE UTILIZED TO DEVELOP ITS WEIGHTED COST OF CAPITAL?

13 A. Yes.  
14

15 Q. DO YOU AGREE WITH THE COMPANY THAT ITS ACTUAL CAPITAL  
16 STRUCTURE IS COMPRISED OF 60% DEBT AND 40% EQUITY?

17 A. No. As of June 30, 2013 the Company's rate base per the MPSC Staff's Direct  
18 Testimony filing consisted of Horseshoe Bend Sewer - \$1,274,431, Shawnee Bend  
19 Sewer - \$276,864, and Shawnee Bend Water - \$1,084,271 for a total rate base of  
20 \$2,635,566 (Public Counsel does have a couple of issues with the MPSC Staff's  
21 rate base recommendations and has filed testimony addressing those issues, but  
22 the issues are relatively immaterial for purposes of this analysis). The only debt in  
23 the Company's name at that date is an Alterra Bank loan of \$1,396,731 with an  
24 interest rate of 5%. Thus, the Company's capital structure based on the MPSC

Staff's investment testimony and Company's debt consists of approximately 53.00% debt and 47.00% equity.

Q. WHAT DOES PUBLIC COUNSEL BELIEVE IS THE COMPANY'S CAPITAL STRUCTURE?

A. Based on the Public Counsel's recommended availability fee adjustments discussed previously in this testimony, I believe that the inclusion of additional CIAC in the Shawnee Bend Sewer and Shawnee Bend Water rate bases is warranted. Therefore, the rate bases of the three utilities would consist of Horseshoe Bend Sewer - \$1,274,431, Shawnee Bend Sewer - (\$428,979) (i.e., \$276,864 less \$705,843), and Shawnee Bend Water - \$752,941 (i.e., \$1,084,271 less \$331,330). Since the adjustment drives the Shawnee Bend Sewer rate base negative no return, i.e., neither debt or equity, should be authorized for that system, but the total rate base for the remaining two systems would be \$2,027,372. Since this rate base is supported by the Alterra Bank loan, the Company's capital structure is 68.90% debt and 31.10% equity.

Q. DOES PUBLIC COUNSEL BELIEVE THAT THE MPSC STAFF'S RECOMMENDED RETURN ON EQUITY IS REASONABLE?

A. No. The 13.89% return on equity proposed by the MPSC Staff, and now accepted by Company's witness as reasonable, is not reasonable or appropriate. If fact, it is based on a hypothetical capital structure which does not exist and is not supported by the evidence since the Company apparently does not have a debt load equal to

1 or exceeding the 75% the MPSC Staff supports. What it is is an extrapolation of  
2 returns for large publicly traded companies which this Company is not and has no  
3 resemblance to.

4  
5 This Utility may be categorized as a small utility but it has had no problems  
6 obtaining financing under its own name as evidenced by the recent financing case,  
7 Case No. WF-2013-0118. Nor, to my knowledge, is it operating under any undue  
8 financial or operational stress. For its size, it is, I believe, a fairly strong well-run  
9 utility and any risks it may be encountering do not appear to have been  
10 insurmountable. Therefore, it is Public Counsel's recommendation that the return  
11 on equity authorized by this Commission be no greater than the return on equity  
12 proposed by the MPSC Staff in Company's last general rate increase case.

13  
14 Q. WHAT WAS THE RETURN ON EQUITY PROPOSED BY THE MPSC STAFF IN  
15 COMPANY'S LAST GENERAL RATE INCREASE CASE?

16 A. In Case Nos. SR-2010-0110 and WR-2010-0111, the MPSC Financial Analysis  
17 Staff (Shana Atkinson) recommended that the Commission authorize an overall  
18 rate of return of 5.50% to 5.66% for Lake Region Water & Sewer Company. The  
19 rate of return recommendation was based on a recommended return on common  
20 equity of 8.00% to 9.00% applied to Lake Region's September 30, 2009,  
21 common equity ratio of 16.36% and a 5.01% embedded cost of debt applied to a  
22 83.64% debt ratio.

1 Q. DID THE MPSC STAFF'S ACCOUNTING SCHEDULES IN THE LAST RATE  
2 CASE UTILIZE AN 8.50% RETURN ON EQUITY TO PRESENT THEIR  
3 REVENUE REQUIRMENT RECOMMENDATIONS AND DID THE PARTIES,  
4 INCLUDING THE COMPANY, AGREE THAT WAS AN APPROPRIATE AND  
5 REASONABLE RETURN?

6 A. Yes, it's my understanding that all the parties, including the Company, agreed that  
7 the 8.50% which was the mid-point of the MPSC Staff's recommended return on  
8 equity range of 8.00% to 9.00% was a reasonable return on equity.  
9

10 Q. IS IT PUBLIC COUNSEL'S RECOMMENDATION THAT THE RETURN ON  
11 EQUITY AUTHORIZED IN THE CURRENT RATE CASE BE 8.50%?

12 A. Yes. The Company's equity ratio has increased significantly since the prior case;  
13 thus, all other things being equal, the Company is likely to be subject to less risk  
14 than it was in the prior case. If an 8.50% return on equity was appropriate then, I  
15 see no reason that it is not even more appropriate now given that the Company's  
16 risk exposure has improved.  
17

18 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

19 A. Yes, it does.  
20  
21