

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of the Request for an                    )  
Increase in Sewer Operating Revenues of        )  
Emerald Pointe Utility Company.                 )

**Case No. SR-2013-0016**

**STAFF'S BRIEF**

**COMES NOW** the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Post-Hearing Brief*, states as follows:

***Introduction:***

Emerald Pointe Utility Company is a small public utility that provides water service to 389 meters and sewer service to 364 customers, primarily residential, near Hollister, Taney County, Missouri.<sup>1</sup> Largely due to a \$1,000,000 debt taken on to finance a major sewer system project, the Company on July 16, 2012, invoked the Commission's *Small Company Rate Case Procedure* at 4 CSR 240-3.050, seeking an increase of \$13,000 in annual water service revenue and \$186,000 in annual sewer service revenue.<sup>2</sup> Staff performed an audit and determined that the Company's annual water service revenues exceed its cost of service by \$49,407 and that its annual sewer service revenues fall short of its cost of service by \$243,459.<sup>3</sup> Staff's audit included a thorough review of the Company's books and records, its general business and customer service practices, and its existing tariff; as well as an inspection of its facilities and a review of its operations. Because an agreement of all the parties on all issues

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<sup>1</sup> Some water service customers have two meters; the actual number of customers for both services is about the same.

<sup>2</sup> In Case No. SA-2012-0362, the Commission approved Emerald Pointe's sewer-system project.

<sup>3</sup> By "cost of service," Staff refers to the Company's annualized and normalized test year operating and maintenance expenses plus a reasonable rate of return and allowance for taxes. See Exhibits 9 (Sewer) and 10 (Water), *Staff's Revised Accounting Schedules*, Schedule 01.

was not possible, Staff moved for an evidentiary hearing on March 14, 2013, as called for in the *Small Company Rate Case Procedure* at 4 CSR 240-3.050(21). The Office of the Public Counsel (“OPC”) also requested a hearing on March 18, 2013, pursuant to 4 CSR 240-3.050(17). Emerald Pointe’s last rate case, Case No. SR-2000-595, was in 1999-2000.

### ***Argument:***

This case is unusual in that it began as a small company rate case, a proceeding intended to result in a negotiated settlement, but the inability of the parties to reach agreement resulted in an evidentiary hearing. The parties have presented ten issues to the Commission for resolution. For some of the disputed issues, Staff and OPC are aligned against the Company; for others, Staff and the Company are aligned against OPC.

#### **ISSUE 1: SEWER COMMODITY CHARGE:**

*Was the Company authorized to collect a sewer commodity charge as a result of Case No. SR-2000-595?*

*If not, what action should the Commission take?*

*If the Company is required to return to customers amounts collected through a sewer commodity charge, what is the appropriate time period over which the amounts due to customers should be calculated?*

*What, if any, interest should be applied to the amounts to be returned?*

*If an over collection occurred, over what period of time should those amounts be redistributed to customers?*

#### **Facts:**

Directly prior to filing this case, the Company’s attorney advised Staff that the sewer-service tariff in Emerald Pointe’s possession was not identical to the version of

that tariff maintained on file by the Commission at its office in Jefferson City in that the Company's version included a sewer-service commodity charge of \$3.50 per thousand gallons on amounts in excess of a base amount of 2,000 gallons.<sup>4</sup> As a result, all amounts collected by the Company through the sewer-service commodity charge since May 10, 2000, when its present tariff took effect, constitute an overcharge.<sup>5</sup> Staff directed the Company to stop charging the sewer-service commodity charge and the Company complied.<sup>6</sup> In the rate case negotiations that followed, Staff insisted that the Company refund a substantial portion of the money collected through the sewer-service commodity charge with interest. The Company refused.

**Analysis:**

Staff's position is that the sewer-service rate schedule approved by the Commission in 2000 is the one maintained by the Commission on file at its offices in Jefferson City. Section 393.130.1, RSMo, states in pertinent part:

All charges made or demanded by any such gas corporation, electrical corporation, water corporation or sewer corporation for gas, electricity, water, sewer or any service rendered or to be rendered shall be just and reasonable and not more than allowed by law or by order or decision of the commission. Every unjust or unreasonable charge made or demanded for gas, electricity, water, sewer or any such service, or in connection therewith, or in excess of that allowed by law or by order or decision of the commission is prohibited.

It follows that the charges in question here were unlawful because they were "more than allowed . . . by order or decision of the Commission" and were therefore unjust, unreasonable and prohibited. In a recent decision, the Missouri Court of Appeals

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<sup>4</sup> Ex. 1, *Busch Direct*, pp. 4-6; Tr. 3:95.

<sup>5</sup> Ex. 1, *Busch Direct*, p. 5.

<sup>6</sup> *Id.*; Tr. 3:95.

stated, "A utility has no right to violate its tariff with impunity."<sup>7</sup> In the case of money collected unlawfully by a utility from its customers, "[t]he utilities have no vested right to or legitimate expectation in monies collected in this manner. To permit them to keep these monies would be a windfall to them[.]"<sup>8</sup>

Can the Commission require Emerald Pointe to disgorge the monies it unlawfully collected? In the traditional world of public utility regulation, the Commission was without authority to order any entity to pay money to another because, as an administrative agency, the Commission was -- and still is -- unable to issue a money judgment.<sup>9</sup> As the Missouri Supreme Court explained in a case concerning a railroad crossing and an attempt by the State Highway Commission to induce the Commission to order the removal from the intersection of structures belonging to the American Petroleum Exchange:<sup>10</sup>

The American Petroleum Exchange is a private corporation and the Public Service Commission did not have and could not exercise any jurisdiction over it. The Public Service Commission is not invested with the power of eminent domain and cannot subject private property to public use. The commission has no power to declare or enforce any principle of law or equity and as a result it cannot determine damages or award pecuniary relief. Neither may the commission abate a nuisance or award consequential damages.

It follows that monies paid by utility customers to a utility for services rendered and billed pursuant to an approved tariff belong to the utility and cannot be refunded by order of the Commission: "When the established rate of a utility has been followed, the

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<sup>7</sup> *State ex rel. Union Electric Company d/b/a Ameren Missouri v. Public Service Commission*, slip op. at 43 (Mo. App., W.D., May 14, 2013).

<sup>8</sup> *State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 59-60 (Mo. banc 1979).

<sup>9</sup> *Wilshire Construction Co. v. Union Electric Company*, 463 S.W.2d 903, 905 (Mo. 1971).

<sup>10</sup> *American Petroleum Exchange v. Public Service Commission*, 172 S.W.2d 952, 955 (Mo. 1943).

amount so collected becomes the property of the utility, of which it cannot be deprived by either legislative or judicial action without violating the due process provisions of the state and federal constitutions."<sup>11</sup> The Court emphasized the distinction between money paid unconditionally, which cannot be refunded, and money paid conditionally, which can be.<sup>12</sup>

We are of the opinion that Springfield Gas and Electric Company, and defendants-appellants, City and Board of Public Utilities of Springfield, lawfully and unconditionally came into the possession, custody and control of the moneys paid by respondents for gas furnished them in intrastate commerce pursuant to lawful rates fixed by rate-making authorities of Missouri. There was no encroachment upon the rights of respondents. They have paid no more than the rates lawfully in effect. In our opinion the money so unconditionally paid as prescribed by the lawfully promulgated and effective rates became and was the property of the distributors, appellants. We cannot ignore our regulatory laws, and we will give effect to constitutional provisions as we understand them. We have said that when the established rate of a utility has been followed, the amount so collected becomes the property of the utility, of which it cannot be deprived by either legislative or court action without violating the due process provisions of the state and federal constitutions.

In the leading case on this question, the Missouri Supreme Court considered the question of refunds with respect to a Fuel Adjustment Clause ("FAC") contained in the tariffs of certain electric utilities.<sup>13</sup> The Court concluded that the FAC was illegal and that the Commission had erred in approving the tariffs containing it.<sup>14</sup> Nonetheless, the Court further held that no refund of the monies paid under the illegal FAC was possible where the funds were paid directly to the utilities and not into the registry of a court.<sup>15</sup>

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<sup>11</sup> *Lightfoot v. City of Springfield*, 361 Mo. 659, 671, 236 S.W.2d 348, 354 (Mo. 1951); *Straube, et al., v. Bowling Green Gas Company*, 360 Mo. 132, 142, 227 S.W.2d 666, 671 (1950).

<sup>12</sup> *Lightfoot*, *supra*, 361 Mo. at 671, 236 S.W.2d at 354.

<sup>13</sup> *St. ex rel. Utility Consumers Council of Missouri, Inc., v. Public Service Commission of Missouri*, 585 S.W.2d 41, 47 (Mo. banc 1979).

<sup>14</sup> *Id.*, at 56-8. FACs are now lawful pursuant to SB 179 (2005), codified at § 386.266, RSMo.

<sup>15</sup> *Id.*, at 58 (emphasis in the original; internal citations omitted).

The Commission has the authority to determine the rate *to be charged*. § 393.270. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery[.] It may not, however, redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process.

However, the Court reached a different result where money was paid under protest and held in a separate fund by a court pending the resolution of the controversy: "***Lightfoot*** does not control the present case because the Industrials did contest the PSC order and they did establish a stay fund. Their money was not unconditionally paid and therefore it did not become the property of [the utility]."<sup>16</sup> The controlling point was whether or not payments to the utility are made conditionally or unconditionally. It should be noted that the finality of payment under the traditional regulatory scheme was beneficial to both company and customer. Just as the customer could not obtain a refund if the amount paid under the tariff happened to exceed the cost of the service received, so likewise the company could not seek additional payments from its customers if the revenue produced by the tariff was less than the cost of the service provided.

Turning to the present case, the starting point of the analysis must be that the payments in question were not paid, either conditionally or unconditionally, pursuant to the terms of a Commission-approved tariff. Rather, the money in question was collected pursuant to no authority at all, in direct contravention of the terms of Emerald Pointe's Commission-approved tariff. Section 393.130.1, RSMo, provides:

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<sup>16</sup> ***State ex rel. Monsanto Co. v. Public Service Commission***, 716 S.W.2d 791, 794 (Mo. banc 1986).

All charges made or demanded by any such . . . water corporation or sewer corporation for . . . water, sewer or any service rendered or to be rendered shall be just and reasonable and not more than allowed by law or by order or decision of the commission. Every unjust or unreasonable charge made or demanded for . . . water, sewer or any such service, or in connection therewith, or in excess of that allowed by law or by order or decision of the commission is prohibited.

Likewise, Section 393.140(5), RSMo, provides:

Whenever the commission shall be of the opinion, after a hearing had upon its own motion or upon complaint, that the rates or charges or the acts or regulations of any such persons or corporations are unjust, unreasonable, unjustly discriminatory or unduly preferential or in any wise in violation of any provision of law, the commission shall determine and prescribe the just and reasonable rates and charges thereafter to be in force for the service to be furnished, notwithstanding that a higher rate or charge has heretofore been authorized by statute, and the just and reasonable acts and regulations to be done and observed; and whenever the commission shall be of the opinion, after a hearing had upon its own motion or upon complaints, that the property, equipment or appliances of any such person or corporation are unsafe, insufficient or inadequate, the commission shall determine and prescribe the safe, efficient and adequate property, equipment and appliances thereafter to be used, maintained and operated for the security and accommodation of the public and in compliance with the provisions of law and of their franchises and charters.

Finally, Section 393.140(11), RSMo, provides:

No corporation shall charge, demand, collect or receive a greater or less or different compensation for any service rendered or to be rendered than the rates and charges applicable to such services as specified in its schedule filed and in effect at the time; nor shall any corporation refund or remit in any manner or by any device any portion of the rates or charges so specified, nor to extend to any person or corporation any form of contract or agreement, or any rule or regulation, or any privilege or facility, except such as are regularly and uniformly extended to all persons and corporations under like circumstances.

In the lead case on the issue of money collected by a utility in contravention of its tariff, the Missouri Supreme Court said:

Since the surcharge thus enabled the utilities to collect monies not collectible under the rate filed at the time the expenses intended to be recoverable under the surcharge were incurred, the utilities have no

vested right in the monies collected. They were not only collected under an established rate which was later determined to have been beyond the authority of the commission to allow, as in the case of the FAC, but were also an additional recovery to that which had been allowed under the rates in force during the relevant period. The result was to require consumers to pay monies which should not have been paid. The utilities have no vested right to or legitimate expectation in monies collected in this manner. To permit them to keep these monies would be a windfall to them and would leave their customers without a remedy for recovery of this unlawfully collected surcharge.<sup>17</sup>

Thus, it may be said to be long-established that a utility may not retain funds collected from its customers in excess of what its tariff allows; this money must be returned to the customers that it was improperly exacted from.

Section 393.140(11), RSMo, quoted at some length above, authorizes refunds of overcharges so long as such refunds “are regularly and uniformly extended to all persons and corporations under like circumstances.”<sup>18</sup> Staff has taken the billing adjustments allowed under Commission Rule 4 CSR 240-13.025 as its guide for fashioning a remedy for the illegal overcharges because the rules at 240-13 do not apply to sewer utilities.<sup>19</sup> However, Emerald Pointe *is* a water corporation and is therefore subject to the Chapter 13 rules. Rule 4 CSR 240-13.025(1)(A) provides:

In the event of an overcharge, an adjustment shall be made for the entire period that the overcharge can be shown to have existed not to exceed sixty (60) consecutive monthly billing periods, or twenty (20) consecutive quarterly billing periods, calculated from the date of discovery, inquiry or actual notification of the utility, whichever comes first[.]

In summary, the Commission should order a billing adjustment designed to return five years’ worth of the overcharge to ratepayers.

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<sup>17</sup> *Utility Consumers’ Council, supra*, 585 S.W.2d at 59-60.

<sup>18</sup> § 393.140(11), RSMo, also authorizes the Commission “to establish such rules and regulations, to carry into effect the provisions of this subdivision, as it may deem necessary, and to modify and amend such rules or regulations from time to time.” Such rules are thus permissive, not required.

<sup>19</sup> 4 CSR 240-13.010(1).



***Interest:***

Staff has also recommended that interest at a 6% annual rate be paid on the refunded overcharges in Issues 1 and 2. Although the payment of interest would be both equitable and just, since the Company has unlawfully possessed its customers' money for twelve years and denied them the use of it, Staff has been unable to find any statutory or regulatory provision authorizing the Commission to order interest on the refund of overcharges.<sup>20</sup>

***Emerald Pointe's Defense:***

Counsel for Emerald Pointe stated the Company's position as follows:

As a result of the conduct of the Company and the Commission it is Emerald Pointe's position that it was authorized to collect a sewer commodity charge in the amount of 3.50 per thousand gallons during this interim period.<sup>21</sup>

At hearing, Emerald Pointe attempted to show that the tariff sheet approved by the Commission was not the tariff sheet issued by the Company and that this was the reason for the unlawful charge. The clear implication was that a former employee of the Commission's Water & Sewer Department, Mr. Randy Hubbs, who was Staff's case coordinator for Emerald Pointe's 2000 rate case, had improperly substituted the sheet without the sewer service commodity charge for the one issued by the Company, which had the charge. Mr. Hubbs did not testify and the Company's expert witness, Dale Johansen, who was manager of the Commission's Water & Sewer Department

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<sup>20</sup> Section 408.020, RSMo, allows creditors to recover interest at 9% interest per annum on debts where no other rate was agreed by the parties, but this statute does not support such an award by the Commission.

<sup>21</sup> Tr. 3:61.

at the time and Mr. Hubbs' supervisor, lacked a clear memory of the events of Case No. SR-2000-595.

Assuming that the facts asserted by the Company are true, what is the legal effect? Such an assumption does not change the fact that the sheet approved by the Commission and maintained on file at its office does not include the sewer-service commodity charge.<sup>22</sup> That sheet is conclusive and determinative under the "Filed Rate Doctrine."<sup>23</sup> That doctrine states that a utility's relationship with its customers is governed by the tariff on file with the state regulatory agency.<sup>24</sup> "A tariff that has been approved by the Public Service Commission becomes Missouri law and has the same force and effect as a statute enacted by the legislature."<sup>25</sup> As state law, a tariff is binding on the utility, the customer and the Commission. A tariff is subject to the same rules of construction as statutes.<sup>26</sup> Under the Filed Rate Doctrine, Emerald Pointe is considered to be on notice of the contents of the tariff sheet on file with the Commission.<sup>27</sup>

Emerald Pointe's attempted defense does not change the fact that the Company has been violating its tariff and overcharging its customers for thirteen years.<sup>28</sup>

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<sup>22</sup> Ex. 1, *Busch Direct*, Schedule 2.

<sup>23</sup> ***State ex rel. AG Processing v. Public Service Com'n***, 340 S.W.3d 146, 150 (Mo. App., W.D. 2011): "The filed rate doctrine ... precludes a regulated utility from collecting any rates other than those properly filed with the appropriate regulatory agency."

<sup>24</sup> ***Bauer v. Southwestern Bell Tel. Co.***, 958 S.W.2d 568, 570 (Mo. App., E.D. 1997).

<sup>25</sup> ***A.C. Jacobs and Co., Inc. v. Union Electric Co.***, 17 S.W.3d 579, 582 (Mo. App., W.D. 2000); ***Bauer v. Southwestern Bell Telephone Company***, 958 S.W.2d 568, 570 (Mo. App., E.D. 1997).

<sup>26</sup> ***A.C. Jacobs***, *supra*, 17 S.W.3d at 584.

<sup>27</sup> ***Cicardi Bros. Fruit & Produce Co. v. Pennsylvania Co.*** 213 S.W. 531, 534 (Mo. App. 1919): "the shipper is bound to take notice of the filed tariff rates, and, so long as they remain operative, they are conclusive as to the rights of the parties[.]"

<sup>28</sup> Ex. 1, *Busch Direct*, *passim*.

Furthermore, Emerald Pointe's attempted defense is simply not credible because it requires not only inexplicable chicanery on the part of Mr. Hubbs, but also an unexplained failure by the Commission's Records Department to transmit a copy of the approved sheet to the Company. What had Mr. Hubbs to gain by an unauthorized substitution of tariff sheets? Why would the Records Department fail in its duty? Under the traditional test of *cui bono*, it is more likely that the Company simply implemented the tariff sheet it preferred rather than the one the Commission actually approved and is now looking for someone at whom to point a finger.

**ISSUE 2: INTEREST ON FEE OVERCHARGE REFUNDS:**

*Should interest be applied to the refund of late fee and reconnection fee overcharges?*

*If so, at what rate?*

*Over what period of time should those amounts be returned to customers?*

**Facts:**

Emerald Pointe violated its tariff by charging a 10% late payment fee rather than the 2% or \$3.00 whichever-is-greater late payment fee specified in the tariff.<sup>29</sup> Emerald Pointe also violated its tariff by charging a \$40.00 reconnection fee rather than the \$30.00 fee specified in its tariff.<sup>30</sup> Emerald Pointe thereby deprived its customers of both the unlawfully-collected overcharges and whatever increase its customers may have realized by investing those funds. Emerald Pointe does not deny the fact of the overcharges and has offered to refund the amount unlawfully collected, without interest, over 24 months.

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<sup>29</sup> Tr. 3:229-230.

<sup>30</sup> *Id.*

**Analysis:**

Emerald Pointe is willing to refund the unlawfully collected amount. However, Staff desires that the refund include interest and that it be made within 90 days. Emerald Pointe contends that the Commission lacks authority to either order interest on the refund or to direct how quickly it is paid.

The analysis is the same as that under Issue 1, above. In the absence of a statute, rule or tariff provision authorizing interest, the Commission cannot require it. However, the Commission can control how quickly the refund is paid. This is a rate case and the refund of significant overcharges to customers is a relevant factor to be considered by the Commission in setting just and reasonable prospective rates.<sup>31</sup> That authority necessarily extends to and encompasses the refund of overcharges.

**ISSUE 3: REFUND OF CUSTOMER DEPOSITS:**

*Over what period of time should deposits be returned to customers?*

**Facts:**

Emerald Pointe's tariff permits it to require a security deposit from water service customers under certain conditions and to hold each such deposit until the customer has established a satisfactory payment history by prompt and complete payment of all undisputed bills over a period of one year.<sup>32</sup> At that time, the tariff directs that the deposit shall be refunded to the customer together with interest at an annual rate of 6%.<sup>33</sup> However, Emerald Pointe did not follow its water service tariff; instead, the Company required a \$30 deposit from each water service customer and held it until the

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<sup>31</sup> *Utility Consumers' Council, supra*, 585 S.W.2d at 49.

<sup>32</sup> Ex. 1, *Busch Direct*, Sch. JAB 3, p. 2 (Paragraph (m)).

<sup>33</sup> *Id.*, Paragraphs (l) and (m).

customer left the system.<sup>34</sup> The total amount in question is about \$11,000 and Staff requests that the Commission direct the Company to return these deposits, plus 6% interest, within 90 days of the disposition of this case.<sup>35</sup> Staff believes that the Company's operations will not be impeded or imperiled by such an order.<sup>36</sup>

***Analysis:***

This issue is quite different from the two previous refund issues. The Company's Commission-approved tariff is the law of the land;<sup>37</sup> that tariff both provides for interest on customer deposits at an annual rate of 6% and requires the refund of deposits plus any interest due to the customers when certain conditions are met. Therefore, as to this issue, there *is* a statute that authorizes the Commission both to order a refund and to order interest. Where there is such authority, the Commission may make such an order.<sup>38</sup> The tariff requires the refund of the customer deposits, with interest, and Emerald Pointe has shown no reason why the refund should not be ordered.

**ISSUE 4: HOLLISTER SEWAGE TREATMENT EXPENSE:**

*What amount of expense related to the sewage treatment performed by the City of Hollister should be recovered in rates?*

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<sup>34</sup> Ex. 1, *Busch Direct*, p. 8. Emerald Pointe also violated its tariff in that it did not calculate the amount of the deposit as the tariff required but simply charged a flat amount of \$30.00.

<sup>35</sup> Tr. 3:243-244.

<sup>36</sup> Tr. 3:245.

<sup>37</sup> ***A.C. Jacobs and Co., Inc. v. Union Electric Company***, 17 S.W.3d 579, 582 (Mo. App., W.D. 2000); ***Bauer v. Southwestern Bell Telephone Company***, 958 S.W.2d 568, 570 (Mo. App., E.D. 1997) (“A tariff that has been approved by the Public Service Commission becomes Missouri law and has the same force and effect as a statute enacted by the legislature”).

<sup>38</sup> See ***State ex rel. Union Electric Company d/b/a Ameren Missouri v. Public Service Commission***, slip op. at 43 (Mo. App., W.D., May 14, 2013).

**Facts:**

This case was initiated by Emerald Pointe because of a major sewer treatment project whereby the Company's existing sewage treatment plant was removed and replaced by a pipeline through which sewage is pumped to the City of Hollister's sewage treatment plant.<sup>39</sup> As a result, Emerald Pointe must now pay the City of Hollister to treat its sewage.<sup>40</sup> Based on lengthy discussions with the Company, Staff included \$75,939 in revenue requirement on an annual basis to cover this expense.<sup>41</sup> Now, after receiving a larger bill than expected, the Company wants to increase the annual allowance for this expense by \$15,188 to \$91,127.<sup>42</sup>

**Analysis:**

The Commission's duty in a rate case is to set just and reasonable rates.<sup>43</sup> One step in this process is to determine the amount of required revenue, that is, the "amount of revenue ratepayers must generate to pay the costs of producing the [utility service] received by such ratepayers while yielding a reasonable rate of return to investors."<sup>44</sup> This "revenue requirement" is "based on the costs and income the company experienced during a historical test year," including "operating expenses, depreciation

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<sup>39</sup> Tr. 3:58-59 (opening statement for Emerald Pointe).

<sup>40</sup> Ex. 25, *Hanneken Direct*, p 2.

<sup>41</sup> *Id.*; and Ex. 9, *Staff's Revised Accounting Schedules (Sewer)*, Sch. 01, p. 1, line 6; Ex. 2, *Busch Surrebuttal*, p. 2.

<sup>42</sup> Ex. 16, *Johansen Rebuttal*, pp. 3-4 and Sch's DWJ-1, DWJ-2.

<sup>43</sup> *State ex rel. KCP&L Greater Missouri Operations Co. v. P.S.C.*, 2013 WL 1964835, 6 (Mo. App., W.D. 2013); *State ex rel. Associated Natural Gas Co. v. P.S.C.*, 954 S. W .2d 520, 528 (Mo. App., W.D. 1997) ("The PSC has the duty to set rates that are "just and reasonable"; any unjust or unreasonable charge is prohibited. § 393 .130.1").

<sup>44</sup> *State ex rel. Capital City Water Company v. P.S.C.*, 850 S.W.2d 903, 903 n. 1 (Mo. App., W.D. 1993).

on the plant, taxes, and an appropriate return on the utility's investment."<sup>45</sup> With respect to operating income and expenses, "[g]enerally accepted rate-making principles permit matters within the test year to be both normalized and annualized."<sup>46</sup> "The purpose of using a normalization to determine the proper amount of expense to include in rates is to find a representative period of time that will most accurately reflect what cost levels are likely to be incurred during the time rates will be in effect."<sup>47</sup>

With these points in mind, Staff objects to Emerald Pointe's now expanded request for additional revenue requirement to cover the cost of sewage treatment expenses owed to the City of Hollister for two reasons: first, the bill that the Company relies on was for a month outside the test year; second, the unusually high volume that month may well be an outlier, a "one month anomaly."<sup>48</sup>

#### **ISSUE 5: LEGAL FEES:**

*What amount of the Company's legal fees should be recovered in rates?*

#### **Facts:**

The updated amount of legal fees to be included in revenue requirement is \$772.<sup>49</sup> It is Staff's understanding that both the Company and OPC agree with this figure.<sup>50</sup>

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<sup>45</sup> *State ex rel. Noranda Aluminum, Inc. v. P.S.C.*, 356 S.W.3d 293, 298 (Mo. App., S.D. 2011).

<sup>46</sup> *Public Service Com'n of Ky. v. Continental Telephone Co. of Ky.*, 692 S.W.2d 794, 799 -800 (Ky. 1985).

<sup>47</sup> *In the Matter of Union Electric Company doing business as Ameren Missouri*, 2012 WL 6643105 (Mo. P.S.C., December 12, 2012)

<sup>48</sup> Ex. 2, *Busch Surrebuttal*, p. 2.

<sup>49</sup> Tr. 3:136, lines 14-21; Ex. 9, *Staff's Revised Accounting Schedules (Sewer)*, Sch. 01, line 17; Ex. 10, *Staff's Revised Accounting Schedules (Water)*, Sch. 01, line 15.

<sup>50</sup> Tr. 3:254-255.

## ISSUE 6: RATE CASE EXPENSE:

*What are the appropriate expenses to be included as rate expense in this case?*

### **Facts:**

Staff included a normalized amount of \$3,912 in revenue requirement, on an annual basis, for rate case expense.<sup>51</sup> Staff admits that this figure does not include all of Emerald Pointe's rate case expenses; the Company testified that it expected to receive additional invoices from its attorney and its expert witness after the hearing.<sup>52</sup> For example, the Company has not yet received the bills for the hearing, which are likely to be substantial.<sup>53</sup>

### **Analysis:**

Staff does not object to holding the record open in order to capture all of Emerald Pointe's reasonable and prudent rate case expenses.

## ISSUE 7: CAPITAL STRUCTURE:

*Should the capital structure of the Company for ratemaking purposes be (1) a structure that treats the Company as one entity or (2) a structure that considers the water and sewer operations of the Company separately?*

### **Facts:**

Staff used the actual capital structure of Emerald Pointe Utility Company, a Missouri general business corporation, in calculating the cost of capital.<sup>54</sup> That structure consists of 29.79% equity and 70.21% debt.<sup>55</sup> All of this debt was incurred by

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<sup>51</sup> Ex. 8, *Rose Surrebuttal*, p. 9; Ex. 9, *Staff's Revised Accounting Schedules (Sewer)*, Sch. 01, line 28; Ex. 10, *Staff's Revised Accounting Schedules (Water)*, Sch. 01, line 26.

<sup>52</sup> Tr. 3:255-259.

<sup>53</sup> *Id.*

<sup>54</sup> Tr. 3:274, 278.

<sup>55</sup> Tr. 3:265-266.



Emerald Pointe to fund its just-completed sewer treatment project.<sup>56</sup> There is no debt directly associated with the water system at this time.<sup>57</sup> Although Emerald Pointe is a single entity, it offers two separate and distinct regulated utility services: water service and sewer service.<sup>58</sup> Because the sewer system and water system are not separate legal corporations, they are unable to issue separate debt, but receive funds from financing issued by Emerald Pointe as an entity.

**Analysis:**

Public Counsel proposes a hypothetical capital structure in order to assign all of the debt to the Company's sewer service customers. While it is true that the debt was incurred to make major improvements to the sewer system,<sup>59</sup> it is secured by all of Emerald Pointe's assets and the assets of its shareholders.<sup>60</sup> Additionally, OPC's proposed alternative will not confer any benefits on the ratepayers or on the Company. There is no practical reason to adopt it. The sewer customers and the water customers are the same people and OPC admitted that its proposal was not made as a matter of inter-customer equity.<sup>61</sup> In fact, their proposal is intended to reflect the sewer rate base versus the water rate base,<sup>62</sup> reflecting OPC's belief that the sewer service customers should pay the sewer service debt.<sup>63</sup>

There are many considerations that must be balanced in the rate design process.

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<sup>56</sup> Tr. 3:268, 274.

<sup>57</sup> *Id.*

<sup>58</sup> Tr. 3:274.

<sup>59</sup> Tr. 3:274.

<sup>60</sup> Tr. 3:278-279.

<sup>61</sup> Tr. 3:275.

<sup>62</sup> Tr. 3:275-276.

<sup>63</sup> Tr. 3:276-277.

Among these are the goal of equity between customers and the notion of matching costs to cost-causers. OPC's testimony on the capital structure issue reveals that its concerns are actually rate design issues and not really capital structure issues. Capital structure is a matter of depicting, as of some moment in time, how a corporation has funded its assets. Because Emerald Pointe is a single corporation, its water service and sewer service assets must be taken together when stating its capital structure. The sewer project debt is secured by Emerald Pointe's water service assets as well as its sewer service assets.<sup>64</sup> The approach used by Staff in this case has also been used, for example, in Ameren Missouri's electric and gas rate cases – an identical ratemaking capital structure is used in both for both operations.

Staff's methodology also calls for the use of a hypothetical capital structure in some cases, for example, where the actual leverage exceeds 75%. In fact, Staff initially proposed a hypothetical capital structure in this case. The accurate depiction of Emerald Pointe's capital structure would not prevent the design of rates that require the sewer service customers to pay the cost of the debt incurred for sewer improvements, should the Commission desire to do so.

#### **ISSUE 8: RATE OF RETURN AND RETURN ON EQUITY:**

*What is the appropriate cost of equity for the Company?*

*What is the appropriate methodology for estimating small water and sewer companies' rates of return?*

#### **Facts:**

Staff used a return on equity ("ROE") figure of 13.26%, calculated by adding a 4% risk premium to the three-month average yield on B+ rated 30-year public utility

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<sup>64</sup> Tr. 3:278-279.

bonds. Emerald Pointe is a small, privately-held public utility corporation with restricted access to capital on reasonable terms. Staff classified Emerald Pointe's business risk profile as "strong" rather than "excellent." After considering the additional leverage incurred by Emerald Pointe to fund its sewer project, Staff classified its financial risk profile as "highly leveraged." Given these facts, Staff considers a ROE of 13.26% to be appropriate for Emerald Pointe.

Small water and sewer companies typically have either no debt or a great deal of debt, while large, publically-traded utility companies generally have nearly equal amounts of debt and equity in their capital structures.<sup>65</sup> OPC admits that Emerald Pointe, in particular, would be considered a risky investment.<sup>66</sup>

***Analysis:***

Staff proposes a ROE of 13.26% and OPC proposes 9.35%. Staff and OPC have a fundamental difference of approach in estimating the ROE for small water and sewer companies. Staff's method, developed in 2010, adds a standard risk premium to the average yield-to-maturity of long-term utility bonds rated consistent with Staff's estimate of the credit quality of the subject company. OPC has not developed a comprehensive methodology to apply to small water and sewer companies for ratemaking purposes. In this case, OPC borrowed pieces of Staff's methodology, such as Staff's risk-premium estimate. OPC added this risk premium to the actual cost of Emerald Pointe's debt, which has deceptively favorable costs due to its restrictive terms – a five-year maturity with a 20-year amortization. Staff's method results in a significantly higher ROE, which is appropriate considering Emerald Pointe's restricted

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<sup>65</sup> Tr. 3:284-286.

<sup>66</sup> Tr. 3:290.

access to capital. Additionally, financial theory teaches that small companies are inherently more risky than large companies.<sup>67</sup> OPC misses the point when it points to the identical risk premia applied by Staff and OPC;<sup>68</sup> the appropriate measure is to compare the estimated Emerald Pointe ROE to that allowed to Missouri-American Water Company. Staff expert Zephaniah Marevangepo testified:

[W]e pretty much look at what is being recommended for large companies, like return on equity that is being recommended to large utility companies and I guess the most recent recommendations were pretty much 7, 9, 8 and we believe small water and sewer companies should get more than that.<sup>69</sup>

Staff's methodology results in an accurate estimated rate of return for small water and sewer companies because it considers the practical limitations these companies have in attracting capital on reasonable terms. The present record shows this plainly: Mr. Snadon had to pledge all of Emerald Pointe's assets as well as substantial assets of his own in order to get the used to finance the sewer project.<sup>70</sup> Mr. Snadon also testified that he has had to infuse his own money into Emerald Pointe on an ongoing basis.<sup>71</sup> Emerald Pointe clearly has only limited access to capital and this reality should be reflected by a higher ROE than those authorized for Missouri's larger, publicly-traded utilities.

#### **ISSUE 9: CIAC RESERVE AND CUSTOMER FEES:**

*What is the appropriate amount of CIAC Reserve to book for customer fees?*

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<sup>67</sup> Tr. 3:288.

<sup>68</sup> Tr. 3:295.

<sup>69</sup> Tr. 3:309-310.

<sup>70</sup> Tr. 3:292-293, 296, 298-299.

<sup>71</sup> CITE!

**Facts:**

Staff's accounting workpapers show that \$29,800 was collected from customers via the \$400 new-water-customer-connection fee.<sup>72</sup> Of this total, only \$12,221 was booked to Plant In Service, leaving \$17,579 unaccounted for.<sup>73</sup> Staff treated the \$17,579 as non-recurring miscellaneous revenue.<sup>74</sup> The discrepancy was the result of Emerald Pointe's failure for some years to book the labor portion of new-water-customer-connection expense to Plant in Service.<sup>75</sup>

**Analysis:**

This is a rate base issue. Rate base is the sum of the utility property devoted to the public service. It is valued at original cost, net of accumulated depreciation. The rate of return is applied to the net rate base in order to generate a return on the shareholders' investment.<sup>76</sup> Utility assets that are provided by the customers rather than by the shareholders are excluded from rate base because they do not represent any investment by the shareholders and thus should not earn a return. Such items are referred to as Contributions in Aid of Construction or "CIAC."

In the small-water-and-sewer-utility world, new customers are charged a connection fee that is intended to be equivalent to the actual cost of physically connecting them to the system.<sup>77</sup> For accounting purposes, the connection fees should be booked to CIAC and the actual costs of meter installation should be booked to Plant

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<sup>72</sup> Ex. 23, *Robertson Rebuttal*, p. 6.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> Ex. 26, *Hanneken Surrebuttal*, p. 4.

<sup>76</sup> The return of the shareholders' investment is provided by depreciation expense.

<sup>77</sup> Ex. 26, *Hanneken Surrebuttal*, p. 3.

In Service.<sup>78</sup> Plant In Service is a rate base account and CIAC is an offset to rate base and it is expected that the connection fee and the actual costs of meter installation will effectively balance each other.

However, Emerald Pointe failed to properly book all of its actual meter installation costs to Plant In Service in the past, with the result that booking all of the associated connection fees to CIAC will materially understate Emerald Pointe's rate base.<sup>79</sup> Therefore, Staff proposes that the excess-past-period-connection fees be treated as miscellaneous, non-recurring revenue.<sup>80</sup> Because it is non-recurring, there is no ongoing revenue requirement effect.<sup>81</sup> Staff expert Lisa Hanneken testified that, despite Staff's treatment of the \$17,579 as miscellaneous, non-recurring revenues, the ratepayers did receive the benefit of their contribution.<sup>82</sup>

#### **ISSUE 10: PLANT-RELATED BALANCE UPDATE PERIOD:**

*Through what period should the plant-related balance be updated?*

#### **Facts:**

Staff has updated plant account balances and related items through February 28, 2013.<sup>83</sup> Staff is unable to update these items beyond that date without violating fundamental ratemaking principles, despite the contrary opinion expressed by OPC witness Ted Robertson.<sup>84</sup> According to the matching principle, all known and measurable factors influencing revenues, expenses and rate base as of a specified

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<sup>78</sup> *Id.*

<sup>79</sup> Ex. 26, *Hanneken Surrebuttal*, p. 4; Tr. 3:325.

<sup>80</sup> *Id.*

<sup>81</sup> Tr. 3:320.

<sup>82</sup> Tr. 3:325.

<sup>83</sup> Ex. 26, *Hanneken Surrebuttal*, p. 7.

<sup>84</sup> *Id.*; Ex. 23, *Robertson Rebuttal*, pp. 7-9.

point in time should be considered in developing the revenue requirement.<sup>85</sup> Staff states that February 28, 2013, is the latest date that Staff can meet this requirement as to plant account balances.<sup>86</sup>

***Analysis:***

The Commission is required to consider all relevant factors when setting just and reasonable prospective rates.<sup>87</sup> Public Counsel urges the Commission to depart from this principle and update a few accounts that will benefit ratepayers. Staff advises the Commission to reject OPC's invitation.

***Conclusion:***

Based on all the foregoing, Staff prays that the Commission will resolve each contested issue as recommended by Staff.

Respectfully submitted,

s/ Kevin A. Thompson  
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<sup>85</sup> Ex. 26, *Hanneken Surrebuttal*, pp. 7-8.

<sup>86</sup> Tr. 3:328-329.

<sup>87</sup> *Utility Consumers' Council*, *supra*, 585 S.W.2d at 49.

**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **6<sup>th</sup> day of June, 2013**, on the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

**/s/ Kevin A. Thompson**