BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Tariff Filing of Algonquin Water Resources of Missouri, LLC, to Implement A General Rate Increase for Water and Sewer Service Customers in its Missouri Service Areas.	))))	**Case No. WR-2006-0425**

REPORT AND ORDER

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REPORT AND ORDER

APPEARANCES

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SENIOR REGULATORY LAW JUDGE: Ronald D. Pridgin.

I. Procedural History

On May 5, 2006, Algonquin submitted to the Commission proposed tariff sheets, effective for service on and after June 4, 2006, that are intended to implement a general rate increase for water and sewer service provided in its Missouri service area. Algonquin's proposed tariffs would increase its Missouri jurisdictional revenues by approximately $584,390 for its water service, and its Missouri jurisdictional revenues by approximately $309,272 for its sewer service. The Commission issued an Order and Notice on May 12, in which it gave interested parties until June 1 to request intervention. No parties asked for intervention.

The parties agreed to a test year consisting of the twelve months ending September 30, 2005, updated for known and measurable changes through September 30, 2006. The Commission held a local public hearing on December 6, 2006, and an evidentiary hearing on January 22-24, 2007.

II. Discussion

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The Commission in making this decision has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

In making its Findings of Fact and Conclusions of Law, the Commission is mindful that it is required, after a hearing, to "make a report in writing in respect thereto, which shall

state the conclusion of the commission, together with its decision, order or requirement in the premises."[1] Because Section 386.420 does not explain what constitutes adequate findings of fact, Missouri courts have turned to Section 536.090, which applies to "every decision and order in a contested case," to fill in the gaps of Section 386.420.[2] Section 536.090 provides, in pertinent part:

> Every decision and order in a contested case shall be in writing, and . . . the decision . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order.

Missouri courts have not adopted a bright-line standard for determining the adequacy of findings of fact.[3] Nonetheless, the following formulation is often cited:

> The most reasonable and practical standard is to require that the findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence.[4]

Findings of fact are inadequate when they "leave the reviewing court to speculate as to what part of the evidence the [Commission] believed and found to be true and what part it rejected."[5] Findings of fact are also inadequate that "provide no insight into how controlling issues were resolved" or that are "completely conclusory."[6]

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[1] Section 386.420.2, RSMo 2000. All further statutory references, unless otherwise specified, are to the Revised Statutes of Missouri (RSMo), revision of 2000.

[2] St. ex rel. Laclede Gas Co. v. Pub. Serv. Comm'n of Mo., 103 S.W.3d 813, 816 (Mo. App., W.D. 2003); St. ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n, 24 S.W.3d 243, 245 (Mo. App., W.D. 2000).

[3] Glasnapp v. State Banking Bd., 545 S.W.2d 382, 387 (Mo. App. 1976).

[4] Id. (quoting 2 Am.Jur.2d Administrative Law § 455, at 268).

[5] St. ex rel. Int'l. Telecharge, Inc. v. Mo. Pub. Serv. Comm'n, 806 S.W.2d 680, 684 (Mo. App., W.D. 1991) (quoting St. ex rel. Am. Tel. & Tel. Co. v. Pub. Serv. Comm'n, 701 S.W.2d 745, 754 (Mo. App., W.D. 1985)).

[6] St. ex rel. Monsanto Co. v. Pub. Serv. Comm'n, 716 S.W.2d 791, 795 (Mo. banc 1986) (relying on St. ex rel. Rice v. Pub. Serv. Comm'n, 359 Mo. 109, 220 S.W.2d 61 (1949)).

A. Jurisdiction

Algonquin is a public utility, a sewer corporation, and a water corporation, as those terms are defined in Section 386.020(42), (48) and (58), RSMo 2000. As such, Algonquin is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

B. Burden of Proof

Section 393.150.2 provides in part, "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . water corporation or sewer corporation, and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

C. Ratemaking Standards and Practices

The Commission is vested with the state's police power to set "just and reasonable" rates for public utility services,[7] subject to judicial review of the question of reasonableness.[8] A "just and reasonable" rate is one that is fair to both the utility and its customers;[9] it is no more than is sufficient to "keep public utility plants in proper repair for effective

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[7] Section 393.130, in pertinent part, requires a utility's charges to be "just and reasonable" and not in excess of charges allowed by law or by order of the commission. Section 393.140 authorizes the Commission to determine "just and reasonable" rates.

[8] St. ex rel. City of Harrisonville v. Pub. Serv. Comm'n of Missouri, 291 Mo. 432, 236 S.W. 852 (1922); City of Fulton v. Pub. Serv. Comm'n, 275 Mo. 67, 204 S.W. 386 (1918), *error dis'd,* 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; City of St. Louis v. Pub. Serv. Comm'n of Missouri, 276 Mo. 509, 207 S.W. 799 (1919); Kansas City v. Pub. Serv. Comm'n of Missouri, 276 Mo. 539, 210 S.W. 381 (1919), *error dis'd,* 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; Lightfoot v. City of Springfield, 361 Mo. 659, 236 S.W.2d 348 (1951).

[9] St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n, 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[10] In 1925, the Missouri Supreme Court stated:[11]

> The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. * * * These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

The Commission's guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.[12] "[T]he dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental."[13] However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.[14] "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."[15]

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[10] St. ex rel. Washington University et al. v. Pub. Serv. Comm'n, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

[11] Id.

[12] May Dep't Stores Co. v. Union Elec. Light & Power Co., 341 Mo. 299, 107 S.W.2d 41, 48 (1937).

[13] St. ex rel. Crown Coach Co. v. Pub. Serv. Comm'n, 179 S.W.2d 123, 126 (1944).

[14] St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n, 585 S.W.2d 41, 49 (Mo. banc 1979).

[15] St. ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

The Commission has exclusive jurisdiction to establish public utility rates,[16] and the rates it sets have the force and effect of law.[17] A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission;[18] neither can a public utility change its rates without first seeking authority from the Commission.[19] A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's.[20] Thus, "[r]atemaking is a balancing process."[21]

Ratemaking involves two successive processes:[22] first, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.[23] The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers. Revenue requirement is usually established based upon a historical test year that focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable

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[16] May Dep't Stores, *supra,*107 S.W.2d at 57.

[17] Utility Consumers Council, *supra*, 585 S.W.2d at 49.

[18] Id.

[19] Deaconess Manor Ass'n v. Pub. Serv. Comm'n, 994 S.W.2d 602, 610 (Mo. App., W.D. 1999).

[20] May Dep't Stores, *supra,*107 S.W.2d at 50.

[21] St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988).

[22] It is worth noting here that Missouri recognizes two distinct ratemaking methods: the "file-and-suspend" method and the complaint method. The former is initiated when a utility files a tariff implementing a general rate increase and the second by the filing of a complaint alleging that the subject utility's rates are not just and reasonable. *See* Utility Consumers Council, *supra,* 585 S.W.2d at 48-49; St. ex rel. Jackson County v. Pub. Serv. Comm'n, 532 S.W.2d 20, 28-29 (Mo. banc 1975), *cert. denied*, 429 U.S. 822, 50 L.Ed.2d 84, 97 S.Ct. 73 (1976).

[23] St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n, 850 S.W.2d 903, 916 n. 1 (Mo. App., W.D. 1993).

operating expenses.[24] The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D) R$$

where: RR = Revenue Requirement;
C = Prudent Operating Costs, including Depreciation Expense and Taxes;
V = Gross Value of Utility Plant in Service;
D = Accumulated Depreciation; and
R = Overall Rate of Return or Weighted Cost of Capital.

The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.[25] The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. Section 393.140(4) authorizes the Commission to prescribe uniform methods of accounting for utilities and Section 393.140(8) authorizes the Commission to examine a utility's books and records and, after hearing, to determine the accounting treatment of any particular transaction. In this way, the Commission can determine the utility's prudent operating costs. Section 393.230 authorizes the Commission to value the property of electric utilities operating in Missouri, that is, to determine the rate base.[26] Section 393.240 authorizes the Commission to set depreciation rates and to adjust a utility's depreciation reserve from time-to-time as may be necessary.

The Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the

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[24] Id., citing Colton, "Excess Capacity: Who Gets the Charge From the Power Plant?," 34 Hastings L.J. 1133, 1134 & 1149-50 (1983).

[25] *See* St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n, *supra.*

[26] Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."

utility's depreciated assets by a Rate of Return. For any utility, its fair Rate of Return is simply its composite cost of capital. The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

D. Overview

1. The Parties

Algonquin is a water and sewer utility and a public utility subject to Commission jurisdiction. The Staff of the Commission is represented by the Commission's General Counsel, an employee of the Commission authorized by statute to "represent and appear for the commission in all actions and proceedings involving this or any other law [involving the commission.]"[27] The Public Counsel is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"[28]

[27] Section 386.071.

[28] Sections 386.700 and 386.710. Also, because OPC is aligned with Staff on almost all the issues, any omission of OPC's position is for the sake of brevity, and not intended as any disrespect to OPC.

2. Algonquin's Proposed Rate Increase

As filed, Algonquin's tariffs would increase Algonquin's annual Missouri jurisdictional water revenues approximately $584,390, and its annual Missouri jurisdictional sewer revenues approximately $309,202.

3. Algonquin's Operations

Algonquin Water Resources of Missouri, LLC (Algonquin) is a Missouri limited liability company. Algonquin Water Resources of America (AWRA), a Delaware Corporation, owns a 100% ownership interest in Algonquin. AWRA is an indirect, wholly owned subsidiary of the publicly traded entity Algonquin Power Income Fund. This fund was established to own energy and infrastructure related assets in the United States and Canada.

Silverleaf Resorts, Inc. (Silverleaf), and AWRA entered into an Asset Purchase Agreement dated August 29, 2004. This agreement provided for the purchase of certain water and sewer systems owned by Silverleaf in the states of Texas, Illinois, and Missouri. The systems in Missouri include the water system at the Holiday Hills Resort (near Branson) and the water and sewer systems at the Ozark Mountain Resort (near Kimberling City) and Timber Creek Resort (near DeSoto). The utility systems, under both Silverleaf and Algonquin, are commonly referred to as "Resort Utilities." The total purchase price amounted to $13.2 million of which $3.8 million is attributable to the Missouri properties acquired.[29]

Silverleaf is the predominate customer of Algonquin, having developed and sold condominiums and timeshares to which it also provided water and sewer service before

[29] Ex. 1, p. 5.

selling the utility assets to Algonquin. When Silverleaf operated the water and sewer systems that Algonquin now owns, Silverleaf's accounting of the utility assets failed to meet the standards that the Commission imposes upon utilities it regulates. It is Silverleaf's lack of proper accounting of its water and sewer assets that leads to many of the complexities of this case.

E. The Issues

As required by the procedural schedule, the parties jointly filed a list of issues to be determined by the Commission. Each party also filed a statement of its position with respect to each issue. In setting out the issues developed by the parties and the parties' stated positions on those issues, the Commission seeks only to inform the reader of these items. The parties' framing of the issues may not accurately reflect the material issues under the applicable statutes and rules. Those issues as formulated by the parties are fully recited at the beginning of the discussion of each issue, set forth below.[30]

1. Pre-1993 Plant

a. What amount, if any, should be reflected as plant-in-service for pre-1993 property?

When Silverleaf operated the Missouri sewer and water systems, it did so under rates the Commission approved in August, 1994.[31] Yet Algonquin discovered that Silverleaf had utility plant in service in 1982 at the Ozark Mountain resort, and in 1984 at

[30] The numbering of the issues is unchanged from the original list. The parties' positions on the issues are discussed, to the extent necessary, elsewhere in this order.

[31] Ex. 1, p. 13.

the Holiday Hills resort.[32] Algonquin wants to have Silverleaf's investment in plant that Silverleaf failed to properly record included in rate base.[33]

Algonquin estimates that unrecorded investment in pre-1993 distribution and collection facilities should increase plant-in-service by $729,427, that unrecorded investment in pre-1993 water supply, treatment and sewage treatment facilities should increase plant-in-service by $1,184,606, and that investment associated with sewer system properties at Holiday Hills that Algonquin did not acquire should decrease plant-in-service by $238,072.[34] This increase in those accounts, Algonquin points out, would be before depreciation.

Algonquin asserts that Staff's insistence that every penny of investment be backed up by paper ignores the reality that the plant was actually in service before 1993, and ignores the reality that Algonquin's predecessor, Silverleaf, was (and still is) a timeshare developer, and had no reason as a timeshare developer to keep books the same way that a regulated utility would.[35] Finally, Algonquin states that because Staff does not dispute Algonquin's numbers, but merely the underlying concept to come up with the numbers, that should the Commission adopt Algonquin's position, its numbers (amount of unrecorded plant to be in rate base) should be accepted.[36]

Staff argues that it did not exclude all pre-1993 rate base, as Algonquin asserts, but that it included roughly $540,000 in rate base, net of depreciation, to the extent that it found

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[32] Id. at 16.

[33] Id. at 18.

[34] Id. at 22-23.

[35] Tr. at 131-32; Ex. 2 at 15.

[36] Ex. 2 at 16.

supporting evidence.[37] Staff asserts that Algonquin has the burden of proof, and that estimates of plant do not carry the day; rather, Algonquin must produce documents such as invoices, checks and contracts to prove cost. Staff states that even to Algonquin's knowledge, the Commission has never used estimates of cost to establish rate base.[38]

Staff argues that Algonquin's attempt to recover any amount over Staff's rate base number is an "end run" around Algonquin's promise to not recover any acquisition premium from the ratepayers. An acquisition premium results when one buys utility property for more than book value.[39] Staff alerted Algonquin of this acquisition premium issue while Algonquin's purchase of Silverleaf was pending.[40]

In that sale case, Case No. WO-2005-0206, Staff warned Algonquin that it considered roughly $2.4 million of the $3.8 million purchase price for Silverleaf's Missouri utility assets to be an acquisition premium that Algonquin could not recover from rate-payers.[41] In fact, even Algonquin's witness is unsure of how Algonquin arrived at the value it decided to pay Silverleaf for its Missouri, Illinois and Texas utility assets.[42] Algonquin agreed not to attempt to recoup any acquisition premium the Commission may determine in a future rate case.[43] The Commission has not allowed acquisition premiums into rate base in the past.[44]

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[37] Ex. 8, pp. 25-26; 30-31; 40.

[38] Tr. 61-62.

[39] Ex. 25, p. 13.

[40] Ex. 9, p. 22.

[41] Commission Case No. WO-2005-0206, *Staff Recommendation* (filed March 28, 2005).

[42] Tr. 55.

[43] See id., Algonquin Statement of Position as to Acquisition Premium and Motion to Cancel Hearing (filed July 25, 2005).

[44] Ex. 8, p. 23.

Further, Staff posits that Silverleaf, in the sale of its timeshares, included the cost of utility plant in its timeshare sales price, meaning that Silverleaf has already recovered its utility plant cost. As a result, if the Commission allows the estimated plant into rate base, customers will pay twice for the same rate base amount. Staff's method of disallowing this plant may result in Silverleaf being paid twice for the same facility, once from its timeshare sales, and again from Algonquin[45], which would result in lower rates for Silverleaf.[46]

Finding: The Commission agrees with Staff's position that Algonquin did not meet its burden. Algonquin purchased utility assets in Missouri, Texas and Illinois for the sum of $13.2 million. Without any proof of the value of the Missouri assets, Algonquin simply claims that $3.8 million of that $13.2 million is attributable to Missouri assets. The Commission finds that $2.4 million of the $3.8 million purchase price for Silverleaf's Missouri jurisdictional assets is an acquisition premium, and therefore unrecoverable from Missouri jurisdictional ratepayers.

Conclusion: The Commission concludes that the proper amount of pre-1993 plant that should be placed into rate base is $543,235, net of depreciation and Contribution In Aid of Construction (CIAC).

[45] Tr. 71.

[46] Tr. 75.

b. What is the appropriate level of post-1992 plant that should be included as plant-in-service?

Algonquin maintains that its post-1992 plant is worth about $4.7 million.[47] supported by Larry Loos' rebuttal and corresponding exhibits. Staff argues for a $3.4 million amount, supported by its EMS runs.

Finding: The Commission finds this issue to be redundant. The rate base issues of excess capacity, construction cost overrun, and CIAC appear to comprise the disputed post-1992 plant**.**

Conclusion: The Commission concludes that it will address this issue in its Conclusions for excess capacity, construction cost overrun, and CIAC.

2. <u>Excess Capacity</u>

Do Algonquin's facilities include plant held for future use, which should not be included in plant in service, because they include excess capacity?

If so, what is the value of the facilities that should not be included as plant-in-service?

This issue involves only the water systems, as Staff concedes there is no excess capacity in the sewer systems.[48] Staff originally recommended a disallowance of approximately $474,000.[49] At hearing, Staff modified its position, asking for a disallowance of $187,972.[50]

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[47] Ex. 2, p. 18; Sch. LWL-3 (updated).

[48] Tr. 162.

[49] Tr. 160.

[50] <u>Id</u>. at 162.

Algonquin hypothesizes that there is no excess well capacity or storage at any of its Missouri resorts.[51] Staff agrees with Algonquin that 1,500 gallons per minute (gpm) is a reasonable flow for two hours' worth of fire protection.[52] At that flow level, Algonquin asserts that it has no excess capacity.[53]

Algonquin stresses the dilemma of a utility deciding whether to build plant: it can be criticized for its inability to provide safe and adequate service if the Commission believes it has built too little plant; it can be criticized for taking having capacity not used and useful for the public if the Commission believes it has built too much. Regardless of whether there may be excess capacity for some time, Algonquin still believes the plant as is was the wisest and most prudent investment. Further, Algonquin quarrels with Staff's choice to disallow the cost of the alleged excess capacity based upon a percentage of the alleged excess; in other words, Algonquin disputes Staff's claim that a 20% excess translates into a 20% disallowance.

Staff counters that it warned Algonquin during its sale case with Silverleaf that Staff believed the water system was overbuilt. Despite admitting the difficulty in quantifying over-capacity[54], Staff recommends a 9% disallowance of the Holiday Hills tank, a 68% disallowance for the tank at Ozark Mountain, and a 28% disallowance for the tank at Timber Creek.

Finding: The Commission finds that Algonquin's facilities do not include plant only held for future use. Algonquin, or its predecessors, reasonably constructed plant to meet

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[51] Ex. 5, pp. 5-8.

[52] Staff's Brief at 17.

[53] Ex. 5, p. 5.

[54] Tr. 165.

current needs, while reasonably estimating future growth, without overburdening current customers.

Conclusion: The Commission concludes that Algonquin has no plant held for future use that should be excluded from rate base.

3. Construction Cost Overrun

Were some of the costs of constructing the facilities imprudently incurred? If so, how much should the plant-in-service accounts be reduced?

Algonquin's predecessor, Silverleaf, sought bids to complete Holiday Hills Well No. 2. Algonquin claims that Staff would require it, or Silverleaf, in this instance, to have perfect hindsight about its management decisions. This, according to Algonquin, is in contrast to the legal requirement that the company use due diligence to address all relevant factors available to it at the time. When the contractor who bid the job was unable or unwilling to complete the Holiday Hills Well No. 2 project according to contract, Algonquin thought it best to move on to the second lowest bidder, rather than engage in protracted and risky litigation against the lowest bidder.

Algonquin's witness on this topic, Charles Hernandez, relied solely on conversations with Michael Brown, a Silverleaf employee, and on materials from Construction Management Services, for his opinion.[55] He was unsure of the number of change orders and the amount of cost increase.[56] He also did not analyze whether remaining with Larry Schneider Construction, the lowest bidder on the job, would have been worth it.[57] All

[55] Tr. 261-265.

[56] Tr. 266.

[57] Tr. 268.

of his knowledge on this topic appears to come from conversations he had with Mike Brown; Mr. Hernandez has no first-hand knowledge of this project.[58]

In contrast with Algonquin's evidence, Staff produced performed its own audit of this project. Staff's audit showed that Silverleaf was not ready to go forward with the project in a timely fashion, and that Silverleaf, not the contractor, was the source of delay.[59] Staff witness Vesely testified that Silverleaf's change from the lowest to the second lowest bidder, the loss of the value of work done by the low bidder, and the excess capitalized interest during the delay period amounted to $186,373.[60] Under cross-examination, Mr. Vesely agreed that an alleged $25,624 billing error from Construction Management Services should not be included in Staff's adjustment.[61]

Finding: The Commission finds that $160,749 of the costs to complete Holiday Hills Well No. 2 were imprudently incurred. Staff's evidence from its audit on this issue is more credible than Algonquin's hearsay evidence.

Conclusion: The Commission concludes that the plant-in-service account should be reduced $160,749.

4. Contributions in Aid of Construction

What is the amount of contributions in aid of construction that should be used to reduce Algonquin's plant-in-service accounts?

The tariffs of Algonquin's predecessor, Silverleaf, provided that when a customer requested the extension of water mains or collecting sewers to the customer, the customer

[58] Tr. 268-270.

[59] Ex. 8, p. 36; Tr.274.

[60] Ex. 8, p. 35.

[61] Tr. 316.

must bear the cost of the extension and contribute the water mains or collecting sewers, at no cost to the utility.[62] Such contributions are referred to as contributions in aid of construction ("CIAC"), and are not included in the rate base of the utility, because the utility has no investment in those facilities.

Algonquin asserts a double-standard from Staff; Staff criticizes Algonquin for estimating its pre-1993 plant-in-service, and states that Algonquin should have documentation for the plant to be included in rate base, but when Staff has no documentation to prove CIAC, Staff glosses over the lack of documentation by estimating what the developer (Silverleaf) must have contributed. This conflicts with Algonquin's tariffs that require a written application and a contract for CIAC.

Staff counters that Silverleaf failed to enforce the terms of its own tariff, in that it failed to record main extensions made by its affiliate development company as CIAC in accordance with the provisions of its tariff. Moreover, allowing Algonquin to recover what Silverleaf should have booked as CIAC would permit Algonquin to benefit from Silverleaf's malfeasance of not enforcing its tariffs.

Finding: The Commission finds that Algonquin has plant that should not be in rate base because it is Contribution in Aid of Construction. Silverleaf's tariff sheets regarding CIAC were binding upon Silverleaf. Neither Silverleaf nor Algonquin should be allowed to include the costs of these extensions of water mains and collecting sewers in rate base merely because Silverleaf failed to enforce the terms of its own tariff sheets. Doing so would result in improperly shifting the burden of paying for such extensions from the

[62] Ex. 8, pp. 17-18 (citing Algonquin's currently effective water tariff, Tariff No. YW-2006-0127, P.S.C MO No. 2, Original Sheet No. 25, and its currently effective sewer tariff, Tariff No. YS-2006-0126, P.S.C MO No. 2, Original Sheets Nos. 24-25).

customer that requested and required them to the Company's ratepayers as a group. Algonquin will be required to record as CIAC the total cost of all such extensions that were required by the tariff sheets to be recorded as CIAC.

Conclusion: The Commission concludes that the amount that shall be recorded as net CIAC for each of Algonquin's systems is as follows: Holiday Hills (water) -- $548,779; Ozark Mountain (water) -- $119,771; Ozark Mountain (sewer) -- $108,215; Timber Creek (water) -- $241,698; and Timber Creek (sewer) -- $191,313.

5. Depreciation Rates

What depreciation rates should be applied to the various elements of Algonquin's plant in service?

Depreciation is an accounting convention under which the value of an asset is reduced proportionately over the course of its useful life. At the end of its life, the asset is considered to have lost all value except residual salvage value. If the accounting convention were perfect, an asset would be fully depreciated at the time it is actually retired, that is, removed from service.[63] In ratemaking, depreciation is an operating expense, the purpose of which is to return to the investors their original investment in an asset as it is consumed in the public service. "The purpose of the annual allowance for depreciation and the resulting accumulation of a depreciation reserve is . . . to enable the utility to recover the cost of such property to it."[64] Depreciation expense is booked to the depreciation reserve, which amount is deducted in ratemaking from the original cost basis

[63] See In the Matter of St. Louis County Water Company, 4 Mo.P.S.C.3d 94, 102-3 (1995); In the Matter of Depreciation, 25 Mo.P.S.C. (N.S.) 331.

[64] St. ex rel. Martigney Creek Sewer Co. v. Pub. Serv. Comm'n, 537 S.W.2d 388, 396-397 (Mo. banc 1976).

of the utility's plant-in-service or rate base. The resulting net rate base is the present value of the investors' capital assets devoted to public service.

The Constitution requires that the investors' original capital outlay be returned to them in rates as the utility's assets are expended in the public service:

> A water plant, with all its additions, begins to depreciate in value from the moment of its use. Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs but for making good the depreciation and replacing the parts of the property when they come to the end of their life. . . . [The Company] is entitled to see that from earnings the value of the property invested is kept unimpaired, so that at the end of any given term of years the original investment remains as it was at the beginning.[65]

Algonquin argues that depreciation reserve ratios should generally fall below 50%, and that Staff's rates result in several accounts having reserve ratios of over 100%, making them unacceptable.[66] Staff states that the high depreciation ratios it suggests are a result of Algonquin having plant out of service, but not yet retired off the books.[67]

The disputed water accounts are: Well Pump – Electric Pump Equipment, Computer Equipment and Software, and Office Furniture and Equipment. The disputed sewer accounts are: Receiving Wells, Pumping Equipment, Computer Equipment and Software, Office Furniture and Equipment, Sewer Plant and Sewer System Development – Engineering.

Finding: The Commission finds that Staff's depreciation rates should be applied to the disputed accounts because those rates more accurately match the reasonably expected service lives of those assets than Algonquin's rates do. Adopting Algonquin's

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[65] Knoxville v. Knoxville Water Co., 212 U.S. 1, 13-14, 29 S.Ct. 148, 152, 53 L. Ed. 371, 381 (1909).

[66] Ex. 3, p. 22.

[67] Tr. 366.

rates would artificially increase the service life of some assets beyond the realm of reasonable, such as doubling service lives of office furniture, computer equipment and software. While Algonquin's approach actually lowers rates by decreasing depreciation expense, it also unreasonably increases the rate base on which Algonquin can earn a return on investment, resulting in ratepayers paying Algonquin's creditors and shareholders for assets that are not, or should not, be serving the customers any longer.

Conclusion: The Commission concludes that the proper depreciation rates are as described in the Direct Testimony of Staff Witness Rosella Schad, Exhibit 20, Schedules 2-1 and 2-2.

6. Capital Structure

What capital structure should the Commission apply to Algonquin's investment in determining the proper rate of return on Algonquin's rate base?

Algonquin argues that the Commission should use the actual capital structure of its parent, Algonquin Power Income Fund, which is 58.21% equity and 41.79% long-term debt.[68] This structure, Algonquin argues, is preferable over Staff's "mythical" structure because it more accurately reflects reality, and is similar to recent capital structures the Commission approved in the KCPL and Empire rate cases.[69] Algonquin claims that Staff's argument that it cannot accurately analyze Canadian markets, such the Toronto Exchange where Algonquin's parent stock is traded, is nonsensical because of the similarities of American and Canadian currencies and economies.

[68] Ex. 3, p. 6.

[69] Brief of Algonquin Water Resources of Missouri, LLC, p. 19 (filed February 20, 2007).

Staff argues for a hypothetical capital structure because the actual capital structure of Algonquin Power Income Fund is organized to distribute more cash flow to shareholders than the capital structure of a regulated water utility would be. Staff recommends a capital structure of 47.88% equity and 52.12% long-term debt, which is more akin to the structures of American regulated water utilities.

Finding: The Commission finds that Algonquin's capital structure should be the same as the capital structure of its ultimate parent company, Algonquin Power Income Fund, as of the end of the September 30, 2006 update period. The Commission agrees that Algonquin's parent's actual capital structure more accurately reflects the capital market in which Algonquin must compete for investment dollars than a hypothetical capital structure would.

Conclusion: Algonquin's capital structure is 58.21% equity and 41.79% long-term debt.

7. Return on Equity

What return on equity should the Commission apply to Algonquin's investment in determining the proper rate of return on Algonquin's rate base?

The Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.[70] The United States Supreme Court, in two frequently cited decisions, has established the constitutional parameters that must

[70] Phillips, The Regulation of Public Utilities, *supra,* 394; Goodman, 1 The Process of Ratemaking, *supra,* 606.

guide the Commission in its task.[71] In the earlier of these cases, Bluefield Water Works, the Court stated that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[72]

In the same case, the Court provided the following guidance as to the return due to equity owners:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[73]

The Court restated these principles in Hope Natural Gas Company, the later of the two cases:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure

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[71] Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

[72] Bluefield, *supra,* 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

[73] Id., 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

> confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[74]

Two principal methods have emerged for determining the cost of Common Equity: these are the "market-determined" approach and the "comparable earnings" approach.[75] The market-determined approach relies upon stock market transactions and estimates of investor expectations.[76] Examples of market-determined methods are the discounted cash flow ("DCF") and the capital asset pricing model ("CAPM").[77] The comparative earnings approach relies upon the concept of "opportunity cost," that is, the return the investment would have earned in the next best alternative use.[78] The comparative earnings approach requires a comparative study of earnings on common equity in enterprises of similar risk, regardless of whether the enterprises are regulated or unregulated.[79]

In the final analysis, it is not the method employed, but the result reached, that is important.[80] The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[81]

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[74] Hope Nat. Gas Co., *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

[75] Phillips, supra*,* 394.

[76] Id.

[77] Id.

[78] Id.*,* at 397.

[79] Id.*,* at 397-98.

[80] Within a wide range of discretion the Commission may select the methodology. Missouri Gas Energy v. Public Service Comm'n, 978 S.W.2d 434 (Mo. App., W.D. 1998), *rehearing and/or transfer denied*; State ex rel. Associated Natural Gas Co. v. Public Service Commission, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981). It may select a combination of methodologies. State ex rel. City of Lake Lotawana v. Public Service Comm'n of State, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

[81] Fed. Power Comm'n v. Nat. Gas Pipeline Co., 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

The annual form of the DCF method of calculating a fair return on common equity can be expressed algebraically by this equation:[82]

$$k = D_1/P_S + g$$

where: k is the cost of equity;
g is the constant annual growth rate of earnings, dividends and book value per share;
D_1 is the expected next period annual dividend; and
P_S is the current price of the stock.

Assuming that dividends grow at a constant annual rate, g, this equation can be solved for k, the cost of equity. The term D_1/P_S is called the dividend yield component of the annual DCF model, and the term g is called the growth component of the annual DCF model.

The CAPM describes the relationship between a security's investment risk and its market rate of return. This relationship identifies the rate of return that investors expect a security to earn so that its market return is comparable with the market returns earned by other securities that have similar risk. The general form of the CAPM is as follows:

$$k = Rf + \beta (Rm - Rf)$$

where: k = the expected return on equity for a specific security;
f = the risk-free rate;
β = beta; and
Rm - Rf = the market risk premium. [83]

Algonquin's and Staff's analysis have many similarities. For example, both use a proxy group of four companies, having three of them in common.[84] Both use a DCF

[82] Ex. 11, Sch. D-2.

[83] Ex. 11 at Sch. E-1.

[84] Ex. 3, p. 9; Tr. 397.

method to estimate cost of equity.[85] Yet, their recommendations on cost of equity are hundreds of basis points apart.

Algonquin's witness, Larry Loos, holds a baccalaureate degree in engineering and a Master of Business Administration, both from The University of Missouri.[86] He is Director of the Enterprise Management Solutions Division at Black & Veatch Corporation, an engineering firm, where he has been employed since 1971.[87] In his duties at Black & Veatch, Mr. Loos has testified before the Commission several times, and has also done so before as several other public utility commissions, upwards of over 100 times.[88] In those times he's testified, Mr. Loos has testified as an expert on cost of capital about five times.[89]

Algonquin's witness, Larry Loos, alleges that the ROE should be in the range of 11.25-12%.[90] For support, Algonquin points to the Hope and Bluefield analysis the Commission recently performed in KCPL and Empire to arrive at ROEs of 11.25% and 10.9%, respectively.

Mr. Loos reminds the Commission that DCF consists of two terms: dividend yield and growth.[91] For dividend yield, he used a ValueLine forecast of dividends and market price for 2007-09 for his lower limit, and forecast dividends and book value to establish an upper limit.[92]

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[85] Id.
[86] Ex. 1, p. 1
[87] Id. at 2.
[88] Id.; see also Tr. 44.
[89] Tr. 376.
[90] Ex. 3, p. 12.
[91] Id. at 9.
[92] Id.

Also, Algonquin reminds the Commission that 75% of its revenues come from a single customer, Silverleaf, and that having one customer with so much control is a risk of unprecedented proportion, regardless of the type of business the customer is in.[93] In addition, Silverleaf itself is in a risky business, the development and sales of timeshares.[94] Moreover, Algonquin serves less than 1,000 accounts in Missouri, whereas Empire serves roughly 215,000 customers in four states, and KCPL serves about 500,000 customers in two states.[95]

Despite this evidence, Staff continues to assert that Algonquin's risk is some 200 to 300 basis points **lower** than the risks of KCPL and Empire. The average returns on equity in the "Edward Jones" report have been in the 9% range, and in the "AUS" utility reports have been just above 10.[96]

Staff focused on its witness, Matt Barnes, having better credentials and using a more reasonable method of coming up with ROE. While Mr. Barnes has less overall experience, Staff points out that his experience in the field of financial analysis exceeds that of the Algonquin witness. However, compared to the five times Mr. Loos has testified as a cost of capital witness, Mr. Barnes done so three times.[97]

Finding: The Commission finds that Algonquin's operating risk is greater than that of a typical regulated water and sewer company, due to its being largely captive to one customer, which, in turn, is also in a risky business venture. The Commission therefore

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[93] Tr. 393.
[94] Id.
[95] Tr. 418.
[96] Tr. 428.
[97] Tr. 407-08.

finds Algonquin's proposed return on equity recommendation more reasonable than that of Staff.

Conclusion: The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's Hope and Bluefield decisions. Pursuant to those decisions, returns for Algonquin's shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of Hope and Bluefield unmistakably requires a *comparative method*, based on a quantification of risk.

The Commission concludes that Algonquin's risk is higher than that of larger American water and sewer utilities. The Commission agrees with Algonquin that it has a higher risk than a "typical" regulated water utility due to its small size, lack of diversity in customer base, and nearly exclusive dependence on resort and timeshare property.[98] Algonquin is all but captive to a single customer, Silverleaf, which, in turn, is in the risky business of the development and sales of timeshares.

The Commission further takes notice of the fact there are solid public policy reasons for promoting investment in small water and sewer companies. Those reasons include, but are not limited to the following reasons: adequately maintaining, upgrading and expanding the existing infrastructure; attracting and compensating professional management that is more capable of managing a regulated utility facing increasingly complex and costly environmental regulations promulgated at the state and federal level; and encouraging the consolidation of properties that will ultimately result in lower costs for ratepayers than it

[98] Ex. 1, p. 33.

would cost the ratepayers otherwise. Therefore, the Commission concludes that the low end of Algonquin's recommended range of 11.25%-12% is appropriate. The Commission will allow Algonquin a return on equity of 11.25%.

8. Payroll Expense

What is the appropriate level of payroll expense that Algonquin should be allowed to recover in its rates?

Algonquin argues that compensation for three employees, Wastewater/Water Utilities Superintendent, Missouri Facility Accountant, and Missouri Utilities Assistant, should all be included in rates. Algonquin claims that it added the Wastewater/Water Utilities Superintendent and Missouri Utilities Assistant in response to complaints and a specific request from Silverleaf, Algonquin's predominate customer.[99] Moreover, Algonquin argues that Silverleaf, a former regulated utility, would understand that its request for these additional positions and the costs associated therewith would likely be recovered from Silverleaf in rates.

Staff agrees that 100% of the expense for the Missouri Facility Accountant should be in rates. However, it believes that only 50% of the Wastewater/Water Utilities Superintendent should be in rates, as that superintendent could spend time working on non-Missouri utility operations.[100] Also, Staff alleges that the Missouri Utilities Assistant should be disallowed entirely, since the position was created after Algonquin bought the system, and the Assistant's position is not needed, because neither the scope nor extent of the operations has expanded since the purchase. Staff admits that Algonquin should

[99] Ex. 7, pp. 2-3.

[100] Ex. 8, p. 7.

respond to its largest customer, Silverleaf, when it wants a personnel change, and that Silverleaf, having run the utility before Algonquin, certainly should understand that, through cost of service, it may have to pay for any personnel additions it requests.[101]

Finding: The Commission finds that Algonquin's three employees, Wastewater/Water Utilities Superintendent, Missouri Facility Accountant, and Missouri Utilities Assistant, are all needed to provide safe and adequate service to Algonquin's customers.

Conclusion: The Commission concludes that Algonquin's three employees, Wastewater/Water Utilities Superintendent, Missouri Facility Accountant, and Missouri Utilities Assistant, are a part of Algonquin's cost of service, and should all be included in rates.

9. Rate Case Expense

1. Should the Commission allow Algonquin to recover in its rates any allowance for the rate case expenses that it incurred in presenting this case to the Commission?

2. If so, how much rate case expense did Algonquin prudently incur, and over how many years should the rate case expense be amortized?

Algonquin requests that the Commission allow it its estimated $225,000 in rate case expense, amortized over five years.[102] Algonquin cites to several Commission orders that said that the Commission must allow prudently incurred rate case expense, or risk violating the company's procedural due process rights. Algonquin states that no law required it to

[101] Tr. 452-453.

[102] Ex. 3, p. 2; Tr. at 480.

first file a small company rate case before filing a formal rate case, and that filing the small company case likely would not have resulted in agreement, thereby delaying the inevitable formal rate case to the company's detriment.[103]

Algonquin also pointed to its predecessor's dissatisfaction with the small company rate case procedure, stating that Silverleaf's rate increase under that procedure took approximately seventeen months. Further, even small company rate cases may require the legal expenses about which Staff complains. Finally, Staff's recommended $5,000 is a random number, having no basis in fact, and assuming that Algonquin would not pursue the formal rate case to which it is entitled.[104]

Staff argues that Algonquin should have used the small company rate case procedure, and that Algonquin filed prematurely by filing before Staff could review Algonquin, rather than Silverleaf, data. Also, Staff maintains any delay Silverleaf experienced in its small company case was its own doing, not Staff's doing. Staff points to evidence showing that it has processed small water company rate cases in an average of about ten months since FY 2004.[105] Staff maintains any financial problems other small water companies have had are independent of the small company rate case procedure. When broken down, Staff asserts that the rate case expense amounts to more than two dollars per week for each of the time share units at Timber Creek, contrasted with KCPL's rate case expense costing each ratepayer about 11 cents per month, and Aquila's rate case expense costing each ratepayer about seven cents per month.[106] Staff witness

[103] Tr. 505, 511, 515.
[104] Tr. 526.
[105] Ex. 35.
[106] Tr. at 518.

Boateng testified that he found $174,954 in actual rate case expense from the documents the Commission requested during the hearing.[107]

Finding: The Commission finds that it should allow Algonquin to recover in its rates some allowance for the rate case expenses that it incurred in presenting this case to the Commission. But the Commission rejects both Algonquin's and Staff's recommendations, and will adopt its own.

The Commission finds Algonquin's request for $225,000 to be amortized over a five-year period to be unreasonably high. Algonquin's $225,000 request is based upon estimates. And, to the extent that Algonquin has evidence for its request, that evidence was supplied to the Commission only upon Commission request during the hearing, and is unsupported by foundational testimony as to the reasonableness of the charges on the bills and invoices.

On the other hand, the Commission also finds Staff's request for $5,000 to be unreasonably low. Algonquin is not obligated to use the Commission's small company rate increase procedure, and should not be punished for choosing the formal rate case option.

During this case, Staff has consistently maintained that Silverleaf and Algonquin had the business acumen to become and stay profitable, so that it has already passed on some costs to ratepayers. If this is so, then Algonquin's acumen must have alerted it to bypass the Commission's small company rate case procedure for a logical reason, such as Algonquin finding the process unwieldy or unfruitful. Like Algonquin's request, Staff's

[107] Ex. 16 (HC) at 11, Tr. 512. The Commission notes that although this number was submitted as Highly Confidential, Algonquin cites this same number in its post-hearing brief, thus thrusting the number into a public forum, and removing the need for protection.

request for the nominal sum of $5,000 is not supported by competent and substantial evidence.

The Commission finds that Algonquin should recover $174,954 of rate case expense. Furthermore, noting that even Algonquin assents to a longer amortization period[108], the Commission will lengthen the amortization period.

Conclusion: The Commission concludes that Algonquin prudently incurred $174,954 of rate case expense, to be amortized over seven years. However, the Commission encourages those utilities eligible to use the small company rate case procedure, including Algonquin, to do so prior to filing a formal rate case. In addition, the Commission will closely scrutinize rate case expense to ensure that the company proves that its legal fees and expert fees are prudently incurred.

10. Rate Design

Should the Commission's order establish separate rates for each of Algonquin's three service territories, or should the Commission's order establish a unified rate for water service to Algonquin's service to the Ozark Mountain and Holiday Hill service territories?

Algonquin states that despite the complete lack of a public outcry for a change in rate design,[109] it does not object to a separate rate for water and sewer services at Timber Creek, and sewer services at Ozark Mountain. However, it believes it should have a single potable water rate for Ozark Mountain and Holiday Hills because of the operational and geographic similarities between the two operations. Finally, Algonquin remarks that a

[108] Brief of Algonquin, at 31.

[109] Tr. 190. Also, OPC has no position on this issue.

separate irrigation rate for non-potable water used to irrigate the Holiday Hills golf course should be established.

Staff argues that separate rates should be established for each Algonquin territory. Staff emphasizes the differences, rather than the similarities, between Ozark Mountain and Holiday Hills. According to Staff, should single rates apply, Ozark Mountain will eventually subsidize Holiday Hills because it will someday be significantly smaller than Holiday Hills. Staff admits that single-tariff pricing allows for rate mitigation when needs for infrastructure occur in the system.[110]

Finding: The Commission finds that in giving an overall rate increase to Algonquin, it would be unfair for some customers to receive rate decreases while other customers receive fairly substantial increases. There is not competent and substantial evidence for the Commission to find that the administrative costs and burdens upon Algonquin and Staff to establish and monitor a multiple tariff utility would provide an overall benefit to Algonquin ratepayers. Therefore, the Commission finds that it should order a unified rate.

Conclusion: The Commission concludes that just and reasonable rates require a unified rate for water service to Algonquin's service to the Ozark Mountain and Holiday Hills service territories. Furthermore, the Commission concludes that just and reasonable rates should also include Algonquin's request to charge $1.25 per thousand gallons of non-potable water used for golf course irrigation.

[110] Tr. 194.

11. Rate Mitigation

Should any increase in rates be phased in, or be otherwise mitigated? If so, how?

Algonquin maintains that the Commission has no authority to order a phase-in of rates. But, Algonquin does not oppose a phase-in for any part of an individual rate increase beyond 100%, assuming that Algonquin would allow it to charge carrying costs to address the loss of revenue. Absent the chance to charge those carrying costs, Algonquin asserts that the phase-in would deprive it of the opportunity for a reasonable return on investment.

OPC favors a two-step phase-in Algonquin mentioned in the hearing, even at the revenue requirement Staff proposes. Staff does not oppose Algonquin's position on this issue.

Finding: The Commission finds this issue in Algonquin's favor. While rate shock is a concern for the Commission, the Commission finds that even under the proposed rate mitigation plan, the brunt of the rate increase would be passed onto ratepayers this spring, with the remainder of it to follow in November. Any such phase-in of rates would give little benefit to ratepayers and may, in fact, impose a revenue requirement upon Algonquin that is less than its cost of service.

Conclusion: The Commission concludes that Algonquin's rate increase should not be phased in.

IT IS ORDERED THAT:

1. That the proposed water service tariff sheets submitted under Tariff File No. JW-2006-0847 on May 5, 2006, by Algonquin Water Resources of Missouri, LLC for the purpose of increasing rates for water service to customers are hereby rejected. The specific sheet rejected is:

P.S.C. Mo. No. 2

2nd Revised Sheet No. 4, Canceling 1st Revised Sheet No. 4

2. That the proposed sewer service tariff sheet submitted under Tariff File No. JS-2006-0848 on May 5, 2006, by Algonquin Water Resources of Missouri, LLC for the purpose of increasing rates for retail sewer service to customers are hereby rejected. The specific sheet rejected is:

P.S.C. Mo. No. 2

2nd Revised Sheet No. 4, Canceling 1st Revised Sheet No. 4

3. That Algonquin Water Resources of Missouri, LLC shall file proposed water and sewer service tariff sheets in compliance with this Report and Order.

4. That all pending motions, not otherwise disposed of herein, are hereby denied.

5. That this Report and Order shall become effective on March 23, 2007.

6. That this case may be closed on March 24, 2007.

BY THE COMMISSION

Colleen M. Dale
Secretary

(S E A L)

Murray, Clayton, and Appling, CC., concur;
Davis, Chm., concurs, with separate
concurring opinion attached;
Gaw, C., dissents;
and certify compliance with the provisions
of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 13th day of March, 2007.