

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

In the Matter of Lake Region Water & Sewer
Company's Application to Implement a General
Rate Increase in Water & Sewer Service

) File No. SR-2010-0110

) Tariff No. YS-2010-0250

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)

In the Matter of Lake Region Water & Sewer
Company's Application to Implement a General
Rate Increase in Water and Sewer Service

) File No. WR-2010-0111

) Tariff No. YW-2010-0251

POST-HEARING BRIEF OF STAFF

PART I

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OF THE STATE OF MISSOURI

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

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Rate Increase in Water & Sewer Service)	

STAFF'S INITIAL POST-HEARING BRIEF

PART I.

COMES NOW the Staff of the Missouri Public Service Commission (Staff) by and through counsel, and respectfully provides the following to the Missouri Public Service Commission (Commission) as its Initial Brief Part I. on the issue of executive management fees requesting that the Commission set the level of executive management fees for services provided to Lake Region Water and Sewer Company by the Management Group, at \$27,901.

Procedural History

On October 7, 2009, Lake Region Water & Sewer Company (Lake Region or Company) submitted to the Commission proposed tariff sheets designed to implement a general rate increase for water and sewer service provided by the Company, along with direct testimony in support of the proposed rates. The revised rates were designed to produce an additional \$331,223 in gross annual water and sewer revenues, excluding gross receipts and sales taxes. The Commission assigned these tariff filings as Case Nos. SR-2010-0110 and WR-2010-0111.

On October 8, 2009, the Commission issued its Suspension Order and Notice, wherein, among other things, the Commission suspended the proposed tariff sheets until

September 6, 2010. Also on October 8, 2009, Lake Region filed Substitute Tariff Sheets to reflect an error in the Company's initial filing. On October 9, 2009, the Commission issued its Second Suspension Order and Notice. The specific tariff sheets suspended were: PSC MO No. 1 (Water) First Revised Sheet No. 4, Replacing Original Sheet No. 4 and First Revised Sheet No. 5, Replacing Original Sheet No. 5; PSC MO No. 2 (Sewer) Second Revised Sheet No. 6, Replacing First Revised Sheet No. 6, and Second Revised Sheet No. 5, Replacing First Revised Sheet No. 7. Subsequently, the following parties requested, and were granted, intervention: Four Seasons Lakesites Property Owners Association, Inc. (Lakesites POA), and Four Seasons Racquet and Club Condominium Property Owners Association, Inc. (Racquet Club).

In preparation for the evidentiary hearing, Lake Region, Lakesites POA, the Office of Public Counsel (Public Counsel), Racquet Club, and Staff filed on March 16, 2010, a Unanimous Stipulation of Undisputed Facts. It also specified that the parties agreed to all aspects of the Staff's case, except for the issue of executive management fees and availability fees.¹ Thus, on March 29 through 31, 2010, the Commission conducted an evidentiary hearing on the issues of executive management fees and availability fees.

Background

Lake Region is a corporation organized under the laws of the State of Missouri in good standing with its principal place of business at 62 Bittersweet Road, Lake Ozark, Missouri 65049. Lake Region possesses a certificate of convenience and necessity issued by the Commission on December 31, 1973, in PSC Case No. 17,975, to provide water and sewer service in Missouri. Lake Region is a water corporation pursuant to Section 386.020(59) RSMo (Supp 2009), a sewer corporation pursuant to Section 386.020(49) RSMo (Supp 2009), and subsequently a public utility within the meaning of 386.020(43) RSMo (Supp 2009);

¹ The brief addressing the issue of availability fees will be submitted to the Commission on June 14, 2010.

thereby subject to the jurisdiction of the Commission pursuant to Section 386.250(3) and (4) RSMo (2000) respectively.

Lake Region provides water service to approximately 600 customers and sewer service to approximately 600 customers in its Shawnee Bend service area; and sewer service to approximately 140 customers in its Horseshoe Bend service area.

Utility System Customers²	Lake Region Customers	Ozark Shores Customers	Combined Total Customers
Shawnee Bend Water	641		641
Shawnee Bend Sewer	615		615
Horseshoe Bend Water		1,790	1,790
Horseshoe Bend Sewer	144		144
Total Customers	1,400	1,790	3,190

Lake Region is unique in that it does not have any employees.³ Lake Region contracts with the Public Water Supply District No. 4 of Camden County (Water District) to operate and manage the day-to-day operations of the Company.⁴ The shareholders of Lake Region are the same shareholders of Ozark Shores Water Company (Ozark Shores). Ozark Shores also does not have any employees,⁵ and operates under contract with the Water District.⁶ The corporate structure of both Lake Region and Ozark Shores establishes an Executive Management Group that controls the overarching strategies of the water and sewer companies and a general manager handles the day-to-day operations of the companies.

The Executive Management Group consists of Brian Schwermann, Robert Schwermann and Vernon Stump. The Executive Management Group interacts with the Water District staff (the same staff as Lake Region and Ozark Shores) and provides executive management oversight on a variety of advanced operational, technological and financial issues that are not generally

² Staff Exhibit 9, Harris Surrebuttal, p. 14.

³ Staff Exhibit 7, Cost of Service Report, p. 24, lines 18-19.

⁴ *Id.* at lines 19-21.

⁵ Transcript, p. 60, line 23; Transcript p. 127, line 14.

⁶ Staff Exhibit 7, Cost of Service Report, p. 24, lines 19-21.

expected to occur in the normal course of day-to-day operations.⁷ Dr. Stump represents the operational-technical side of the business, while the Schwermann's (Mr. Robert Schwermann and Mr. Brian Schwermann) collectively represent the financial side of the business.⁸ In September 2009, Dr. Stump was appointed as the President of Lake Region and Ozark Shores.⁹ Robert Schwermann was the President of Lake Region and Ozark Shores, and Brian Schwermann is currently the Secretary and Treasurer of the Company.¹⁰

As general manager of the Water District and as contract general manager of Lake Region and Ozark Shores, John Summers has the authority to oversee the day-to-day operations of both Lake Region and Ozark Shores, as well as the Water District.¹¹ Mr. Summers also recommends expenditures for the repair, maintenance, capital additions, and expansions of Lake Region and Ozark Shores.¹² However, these recommendations must be approved by the Executive Management Group.¹³

Executive Management Fees

The issue currently before the Commission is a determination of what is the appropriate level of executive management compensation to be included in Lake Region's revenue requirement for setting Lake Region's water and sewer rates.

The Commission should set the level of executive management fees for services provided to Lake Region Water and Sewer Company by the Executive Management Group, Brian Schwermann, Robert Schwermann and Vernon Stump, at \$27,901. This amount should be allocated between the three operating systems as follows; Shawnee Bend Water \$7,115,

⁷ Staff Exhibit 9, Cost of Service Report, p. 25, lines 4-8.

⁸ Transcript p. 150, lines 7-12.

⁹ Staff Exhibit 9, Cost of Service Report, p. 25, lines 4-8.

¹⁰ *Id.*

¹¹ *Id.* at p. 9, lines 10-15.

¹² Staff Exhibit 7, Harris Surrebuttal p. 24, lines 24-27.

¹³ *Id.* at p. 25, lines 1-2.

Shawnee Bend Sewer \$7,477 and Horseshoe Bend Sewer \$13,309, and should be included in Lake Region's cost of service.

When determining what level should be included in Lake Region's cost of service, the Commission must consider whether that amount is just and reasonable for customers to pay.¹⁴ Lake Region has the burden of proving that its proposed cost of service for executive management fees is just and reasonable and should be included in rates.¹⁵ Lake Region has not met its burden of proof that the requested \$50,000 for executive management fees is just and reasonable.¹⁶ The Executive Management Group does provide a benefit to the Company, a \$27,901 benefit to Lake Region. The benefit is not worth the \$50,000 amount Lake Region has proposed to put in rates, but is worth more than \$600 value Public Counsel has proposed.

Staff's witness, William Harris, compared the average annual executive salary of the Company with salaries published by Missouri Economic Research and Information Center (MERIC) for chief executives in the Missouri's Central Region (including Camden County).¹⁷ Mr. Harris also reviewed the American Water Works Association 2008 Water Utility Compensation Survey for executive salaries.¹⁸ Mr. Harris determined an hourly rate of \$63.77 was reasonable and not subjective.¹⁹

In determining a reasonable amount of the executive management fees to be included in Lake Region's cost of service, Mr. Harris conducted extensive interviews with the Executive Management Group and Mr. Summers in both the Overland Park office and Lake Ozark office.²⁰ Mr. Harris toured the Lake Region facilities.²¹ Mr. Harris spent a total of

¹⁴ See RSMo § 393.130.1 (2000).

¹⁵ RSMo § 393.150.2 (2000).

¹⁶ Transcript p. 127, lines 9-14; See RSMo § 393.150.2 (2000).

¹⁷ Staff Exhibit 9, Cost of Service Report, p. 10, lines 2-5.

¹⁸ *Id.* at p. 9, lines 21-22.

¹⁹ *Id.* at p. 10, lines 7-9.

²⁰ Transcript p. 151, lines 1-5.

four days at the Lake Ozark location.²² Then Mr. Harris met and interviewed the Executive Management Group at the Overland Park office.²³ Mr. Harris reviewed and inspected telephone records of the Executive Management Group and reviewed and inspected the travel expenditures of the Executive Management Group.²⁴ While Mr. Harris did not review any time sheets from the Executive Management Group, he found no reason to doubt that the Robert Schwermann, Brian Schwermann, and Dr. Stump each worked approximately three to four days a month on both the Lake Region and the Ozark Shores entities.²⁵

Based upon this investigation, Mr. Harris concluded that it was reasonable to allow a salary for two executive management functions, rather than for each individual of the Executive Management Group.²⁶ Mr. Harris identified that Dr. Stump represents the operational-technical side of the business, while the Brian Schwermann and Robert Schwermann collectively represent the financial side of the business.²⁷

In Mr. Harris' proposal he included three eight-hour days per month per function to provide executive management oversight for both Lake Region and its affiliate Ozark Shores.²⁸ This included two days at Lake Region's Lake Ozark facility and one day from a remote location.²⁹ Mr. Harris also included lodging, meals and travel costs associated for the Executive Management Group's Lake Ozark visits.³⁰ Staff's recommendation includes communication costs for the Executive Management Group.³¹ Mr. Harris's recommendation

²¹ Transcript p. 151, line 11.

²² Transcript p. 154, lines 6-11, 25; Transcript p. 155, line 1-2; Transcript p. 155, lines 8-16

²³ Transcript p. 156, lines 6-9.

²⁴ Transcript p. 156, line 18 – p. 157, line 5; Transcript p. 157 line 11 – Transcript p. 159, line 9.

²⁵ Transcript p. 161, lines 23-25.

²⁶ Transcript p. 149, lines 20-25.

²⁷ Transcript p. 150, lines 7-12.

²⁸ Staff Exhibit 9, Cost of Service Report, p. 10, line 21.

²⁹ *Id.* at p. 10, line 23.

³⁰ *Id.* at, p. 11, line 1; Transcript p. 149, lines 11, 14.

³¹ Staff Exhibit 9, Cost of Service Report, p. 11, lines 2-3.

includes ten percent of the overall rent for the Overland Park office to be split between Ozark Shores and Lake Region because Brian Schwermann and Robert Schwermann conduct business for the regulated entities out of the Overland Park office.³² Mr. Harris only allowed ten percent for rent in the Overland Park office because the office space is shared with other non-regulated entities the Schwermanns' operate.

Even though part of the Executive Management Group prepares and participates in the annual board of directors meeting for Lake Region, the Executive Management Group provides duties beyond the scope of a board of directors.³³ Mr. Harris stated that what is "important to remember here is that non-employee board members who are not compensated in any other manner than through board of director fees do not make the managerial proposal such as capital expenditures. Those decisions are present[ed] to the Board for approval." ³⁴ He further added that "[b]oard of directors do not negotiate labor agreements or other contracts affecting the utility operations; do not develop capital and operating budgets and do not get directly involved in the operational issues of running a public utility like Lake Region and Ozark Shores." ³⁵

The Executive Management Group is a separate and distinct group from the board of directors.³⁶ Dr. Stump stated "[b]oard members typically review data prepared by the management team, set policy and provide direction of the management team. Negotiations with banks on financing, meeting with field personnel and consulting engineers to develop solutions and meeting with both vendors and customers are not customary duties for members of the board." ³⁷ Further, Dr. Stump stated that "the quicker road to ruin a company in any industry

³² Transcript p. 159, lines 24-25.

³³ Staff Exhibit 9, Cost of Service Report, p. 3 lines 1-25.

³⁴ *Id.* at p. 4, lines 5-8.

³⁵ *Id.* at lines 8-11.

³⁶ Transcript p. 136, line 13.

³⁷ Lake Region Exhibit 2, Stump Rebuttal, p. 2, lines 16-20.

[is for] executive management to try to run a business from an ‘ivory tower.’ In my experience if executive management does not visit the site of company operations at least once a month, then the Executive Management Group will quickly lose touch with how the business is operating and the operation begins to deteriorate.”³⁸

During the evidentiary hearing, Lake Region’s witness Dr. Stump verified Mr. Harris’s assertion that each member of the Executive Management Group works approximately three days for Lake Region and Ozark Shores.³⁹ Dr. Stump testified that his role is the operational executive⁴⁰ in charge of the overall direction of the company⁴¹ while both Brian Schwermann and Robert Schwermann’s roles are the financial executives handling the financial services, taxes, and accounting issues.⁴²

While Lake Region’s witness did provide information regarding the Executive Management Group’s duties and responsibilities to Company, it did not provide a reasonable basis for its \$50,000 request. Lake Region’s basis was that the Executive Management Group should get at least the same amount of money as the Public Service Commission assessment.⁴³ That position is completely illogical and unfounded.

At the other extreme, Public Counsel’s entire proposal is to allow \$200 per board member to attend Lake Region’s annual board meeting equating to only \$600 per year for the three board members to attend one meeting.⁴⁴ Staff believes the amount proposed by Public Counsel is inadequate to provide executive oversight to two regulated utilities, Lake Region and its affiliate Ozark Shores. The Executive Management Group meets monthly.

³⁸ Lake Region Exhibit 3, Stump Surrebuttal, p. 3, lines 6-11.

³⁹ Transcript p. 123, lines 18-19.

⁴⁰ Transcript p. 125, lines 10-18.

⁴¹ *Id.*

⁴² *Id.* at line 21; Transcript p. 126, lines 1-5.

⁴³ Transcript p. 126, line 15.

⁴⁴ Transcript p. 179, line 13; Transcript p. 187, lines 17-23.

Dr. Stump travels from Texas to Lake Ozark once a month to meet with Mr. Summer's and the Executive Management Group and to oversee operations,⁴⁵ while Brian Schwermann and Robert Schwermann travel from Kansas City, Kansas to Lake Ozark once a month to meet with the Executive Management Group, Lake Region and Ozark Shores.⁴⁶ These facts demonstrate that Public Counsel's proposal is too low to provide appropriate oversight for two regulated utilities.

Unlike Staff members, Public Counsel's witness, Ted Robertson did not visit either Lake Region's Lake Ozark facilities or Lake Region's Overland Park, Kansas office.⁴⁷ Mr. Robertson's only face to face contact with the Executive Management Group was at the prehearing conference and evidentiary hearing.⁴⁸ Furthermore, Mr. Robertson did not include any cost study comparison when making his adjustment to Lake Region's proposal. Mr. Robertson limited his investigation into the Executive Management Group to a data request that stated Lake Region did not have any employees and therefore he concluded he did not need to continue his investigation.⁴⁹

Public Counsel asserted that there is "no other similarly-sized and structured utility in this State that requires three executive manager[s], in fact, [Mr. Robertson] believe[s] that most of those utilities are managed by a single person."⁵⁰ However, when questioned by Staff's counsel, Mr. Robertson indicated that he had not done a comparison of Lake Region's revenues compared to other similarly sized utilities in Missouri.⁵¹ Contrary to Public Counsel's lack of detailed investigation, Staff's witness Mr. Harris included a chart in his surrebuttal testimony identifying

⁴⁵ Transcript p. 124, line 13.

⁴⁶ Transcript p. 124, line 19.

⁴⁷ Transcript p. 173, line 21.

⁴⁸ Transcript p. 174, lines 1-6.

⁴⁹ Transcript p. 170, line 2 – p. 171 line 22.

⁵⁰ Public Counsel Exhibit 4, Robertson Surrebuttal, p. 8, lines 8-10.

⁵¹ See Transcript p. 175.

five utilities that report “management fees” as an outside service or paid executive/owner a salary for the service and compared them to Staff’s management fees for Lake Region:

Name of Utility	# of customers	Management fee (\$)	\$ per customer
Aqua Missouri, Inc.	3,441	\$150,815	\$43.83
Roarke Water and Sewer, Inc.	1,290	\$ 33,369	\$25.87
House Springs Sewer Company	unknown	\$ 59,383	unknown
Timber Creek Sewer Company	1,313	\$ 70,510	\$53.70
U.S. Water Company	2,135	\$ 97,200	\$45.53
Lake Region Water & Sewer	3,190	\$ 27,901	\$19.93

The concept of including executive management fees into the cost of service for a water and sewer utility is just and reasonable. Several of Missouri’s water and sewer utilities operate under a similar corporate structure, as shown in the above chart.

Staff included \$27,901 in Lake Region’s cost of service for executive management fees.⁵² This number was based on a reasonable amount for executive salaries, travel, lodging, corporate office and communication costs.⁵³ This amount should be allocated between the three operating systems as follows: Shawnee Bend Water \$7,115, Shawnee Bend Sewer \$7,477 and Horseshoe Bend Sewer \$13,309, and should be included in Lake Region’s cost of service. Staff’s amount is just and reasonable and the Commission should set the level of executive management fees at the level defined herein.

⁵² Staff Exhibit 9, Cost of Service Report, p. 6, lines 1-2.

⁵³ *Id.* at p. 5, lines 17-18.

WHEREFORE, the Staff submits the foregoing as its Initial Post-Hearing Brief, Part I.
in this matter.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 28th day of May 2010.

/s/ Jaime N. Ott