STATE OF MISSOURI

PUBLIC SERVICE COMMISSION

ORAL ARGUMENT

February 5, 2008
Jefferson City, Missouri
Volume 1

In the Matter of the Application of Middle Fork Water Company for an Order Initiating an Investigation to Ascertain the Value of the Company's Property Devoted to the Public Service	)	Case No. WO-2007-0266

BENJAMIN LANE, Presiding,
REGULATORY LAW JUDGE

ROBERT CLAYTON,
TERRY JARRETT,

COMMISSIONERS.

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P R O C E E D I N G S

JUDGE LANE: Good afternoon, ladies and gentlemen. My name is Benjamin Lane. I'm the regulatory law judge assigned to this case which is Case No. WO-2007-0266, and that's captioned: In the Matter of the Application of Middle Fork Water Company For an Order Initiating an Investigation to Ascertain the Value of the Company's Property Devoted to the Public Service.

We're here today -- and it's about 1:47 on Tuesday afternoon, February 5th, 2008, and we're in room 305 at the Commission's office -- offices in the Governor's office building. We're here today pursuant to the Commission's order of January the 31st, 2008, rescheduling this matter for oral argument.

As you know, the issues before the Commission in this case have now been fully briefed by the parties and are ripe to be decided, but the Commission believed that it would be helpful to hear oral argument on those issues because they're somewhat novel and they involve legal and regulatory policy issues that are likely to arise in other cases and certainly could be live issues in cases to come down the road.

So we invited the parties or directed the parties to participate in this oral argument on the pending application which has been pending for quite some time. As a matter of fact, I believe it's my oldest -- my oldest case. And we got here through a long, kind of crooked road, and a lot of people have put in a lot of work and we're now to the point where the Commission feels that it's ready to decide this matter on the pleadings.

So the purpose of our hearing today is to give the parties one last shot at advocating their positions on these -- on the legal and regulatory policy issues that -- that face the Commission in this case and add to the eloquence of your already well-written briefs on this issue, so one final chance to do that.

As far as the procedure goes, I think we'll be a pretty open format here. As the proponents of its report and recommendation, I'm gonna go ahead and have Staff begin, and then Staff will be followed by Middle Fork and then Office of Public Counsel if they wish to participate in the oral argument as well will go next.

I expect the argument to be somewhat free form. This isn't like the Court of Appeals where we have a clock timing down and points relied on, and also I would expect if you get interrupted during your argument by the -- the -- any of the commissioners that are present right now or will be present or me, so be expected -- be ready for that should it happen.

But before we do that, I want to go ahead -- and I know you have submitted written entries of appearance, but just for the record, could we go ahead and get entries of appearance from the parties that are represented here today? Let's -- let's start out with Middle Fork Water Company.

MR. MITTEN: Your Honor, Russ Mitten, Brydon, Swearengen and England, 325 East Capitol Avenue, Jefferson City, Missouri 65102, appearing on behalf of Middle Fork Water Company.

JUDGE LANE: Thank you, Mr. Mitten. And I see you have your client, the president, here today.

MR. MITTEN: Yes, Brock Spose, the president of Middle Fork is also here with me today.

JUDGE LANE: Welcome, sir.

MR. SPOSE: Thank you.

JUDGE LANE: For the Staff of the Commission.

MR. KRUEGER: Keith R. Krueger for the Staff of the Missouri Public Service Commission. My address is P.O. Box 360, Jefferson City, Missouri 65102.

JUDGE LANE: Mr. Krueger, thank you and welcome. For the Office of Public Counsel.

MS. BAKER: Thank you, your Honor. Christina Baker, Senior Public Counsel, P.O. Box 2230, Jefferson City, Missouri 65102, appearing on behalf of the Office of Public Counsel and the ratepayers, and with me today is Russ Trippensee.

JUDGE LANE: Thank you, Ms. Baker, and again, welcome to -- to the argument this afternoon.

Are there any -- is there anyone here, any parties that I missed or anyone that's here that needs to enter an appearance on behalf of a client, intervenor? I don't think we have any intervenors, but if we did.

(NO RESPONSE.)

JUDGE LANE: No? All right. I think we've got everyone.

And I also want to thank Commissioner Jarrett for -- for being here today in person. I know some of the commissioners are next door in a -- in a very exciting rulemaking public hearing. I expect this -- this to be perhaps maybe a little bit more lively than those --

COMMISSIONER JARRETT: It was lively as well.

COMMISSIONER CLAYTON: I was sitting in there waiting.

JUDGE LANE: That's Commissioner Clayton, just for the record, and thank you. Sorry -- I'm glad you wandered in because I -- I might have made a check here after a few minutes just to catch any stragglers.

I was just explaining we're just about to begin and I was kind of setting forth the ground rules basically that Staff will go first in whatever format they like since they're the proponent of the Staff report and recommendation that is before the Commission now.

They'll be followed by Middle Fork and then by Office of Public Counsel, and I indicated they should all be ready just as if it were an oral argument before an appellate court, for example, to expect interruptions from time to time from either me or the commissioners that are present.

So I think without further adieu, let's go ahead and get things started. Let me see if I can get this camera set up to where I can actually see something. Okay. I think that will work. Again, this is a little unusual in terms of that. If you don't have a problem with just speaking from your -- from your positions at the table, we're pretty -- we're pretty informal here. So Mr. Krueger, if you would -- if you'd like to open things up.

MR. KRUEGER: Thank you, your Honor. Good afternoon, may it please the Commission. My name is Keith R. Krueger and I represent the Staff of the Missouri Public Service Commission in this case.

In the briefs that the company filed, Mr. Mitten stated that -- or suggested that the Staff was seeking to disregard 100 years of -- nearly 100 years of precedent. And my reaction to that was that -- to paraphrase Dan Quail's famous statement, 100 years of precedent is a terrible thing to lose. But I don't think we're in danger of losing it.

Mr. Mitten's statement is incorrect. The Staff is not asking the Commission to disregard 100 years of precedent. We're just asking that the Commission not recognize as plant-in-service the plant that has been paid for -- has already been paid for by the customers of the company.

I want to begin by describing the series of financial transactions as I understand them that led to the position that we are now in.

The first -- the first one was maybe not chronologically but as far as a logical trail, the first one is the Environmental Improvement and Energy Resources Authority, the EIERA, sold bonds to members of the public. I understood they were from the local area where -- where Middle Fork is located. That's not important for purposes of this case. They sold about $2 million worth of bonds, and the people who purchased the bonds gave the EIERA money. And in exchange, the EIERA gave them the bonds, their promise to repay the money, according to a particular schedule. EI -- EIERA executed the indenture, issued the bonds and borrowed the money.

The next step is that EI -- EIERA loaned the money to Middle Fork. EIERA took the proceeds of these loans -- of these bonds, loaned them to Middle Fork and Middle Fork executed a promissory note in the amount of 200 -- of $2 million to be repaid according to a schedule. EIERA gave Middle Fork money, and in exchange, Middle Fork promised to repay it. As Mr. Mitten has appointed out, Middle Fork is the only party that's obligated to EIERA on these bonds -- or on these -- on this promissory note, I should say.

The next step is Middle Fork constructed the facilities, they went out and hired contractors, constructed the water facilities that Grant City and Stanberry needed, so Middle Fork gave the contractors money and the contractors gave -- gave them the water treatment facilities and supply facilities.

JUDGE LANE: Now, I just want to make -- make -- make this clear in my mind. Middle Fork and only Middle Fork is liable to repay the bonds, right?

MR. KRUEGER: Correct. I -- well, actually, the bonds were issued by EIERA. Middle Fork gave EIERA a promissory note. Middle Fork is the only one that's obligated on that note.

JUDGE LANE: On the note.

MR. KRUEGER: Correct.

JUDGE LANE: Okay. Thank you.

MR. KRUEGER: Next, Middle Fork executed agreements with the cities of Grant City and Stanberry by terms of which they agreed to provide water to these cities in exchange for certain payments. The payment consisted of two parts: The first part was a usage charge which is a charge based on the number of thousands of gallons of water that Middle Fork sells to each city, and the city pays them an amount to be established by the Commission which is sufficient to cover the company's operating expenses including a return on equity.

The only equity the company had in -- in these facilities at that time was about 10 percent of the -- of the cost of the plant. The other 90 percent was financed by their loan from EIERA.

The second part of the payments that the cities agreed to pay was the surcharge, and the surcharge was an amount that was -- that is specified to be exactly equal to the amount that Middle Fork must pay to EIERA on its promissory note. So the cities agreed to pay Middle Fork that amount of money, and in exchange for that, they received nothing.

So now let's -- let's follow the money that was issued pursuant to these loans. The company pays the money that is -- that is established by its note to EIERA and it collects an exact same amount of money from the cities. The money just pass -- essentially just passes through the hands of the cities -- I mean the hands of the customer, from the cities to the company to EIERA, and the amount is exactly unchanged.

And the company is, in fact, the only

party that's obligated to pay the EIERA, as I mentioned earlier. But if the cities pay as they are required to pay, as they have agreed to pay, the -- Middle Fork will not have to come up with any money out of its pocket. The money will just pass from the cities to Middle Fork to EIERA.

In the explanatory pleading that the Staff filed, I said, in essence, Middle Fork acts much like a guarantor of the loans. I think that's true. I didn't say that Middle Fork was a guarantor of the loans. They're not a guarantor of the loans, but they act in some respects like a guarantor. A guarantor only has to pay money if the principal defaults on the obligation to pay money. Middle Fork would only have to pay anything out of its own pocket if the cities defaulted on their obligation to pay the money according to their water purchase -- purchase agreements. So Middle Fork is not a guarantor, but they act much like one. They only have an obligation out of their own pocket if the cities fail to pay.

Now, in the company's response, Mr. Mitten said that Staff argued that Middle Fork is nothing more than a guarantor, and that's a quote from that brief, and that's just a misstatement. I did not say that Middle Fork is nothing more than a guarantor. I said they act much like a guarantor. In essence, Middle Fork has no skin in this game. It has a debt to the EIERA but the cities are the ones that are obliged to pay a sufficient amount of -- amount of money so that they can pay it off.

In my explanatory proceeding, I also talked about -- made an analogy to connection charges. I said that the payments that the cities make on the surcharge may be likened to the connection charges that developers or customers make as they develop -- as a development builds out. I didn't say that they were connection charges, I said that they may be likened to connection charges in that the customers pay the money to the company for which they receive nothing in exchange. The connection charges are treated as CIAC for this reason, and the surcharge when -- when connection charges are imposed on customers, they are treated as CIAC, and a surcharge should be treated the same way.

The cities are making a payment to the company for which they receive nothing in return because remember that the usage charges cover all of the costs of SERCs. The cities are paying to Middle Fork on the first part of their payment, their obligation, a usage charge which is equal to all of the costs of service including return on equity. The only proper way to describe the other payment, the surcharge, is to call it a contribution.

Mr. Mitten also argued that the payments that the cities make to the -- to the company do not meet the USOA definition of CIAC, and I would disagree with that as well. He said that according to the definition to the USOA definition of CIAC, to qualify as CIAC assets, quote, one must be in the form of money, service or assets that are provided to a utility by a third party; and two, the money, services or assets must be cost-free to the utility, unquote.

The surcharges and the payments in this case to the extent that they are used to pay principal on the debt service of the loan from EIERA to Middle Fork, those surcharge payments do meet the definition of CIAC. They are money that is provided to the utility by a third party, and the money is cost-free to the utility. The city's payment toward principal should be classified as CIAC.

The cities have already been paying Middle Fork for a period of about 16 years, a large amount of money which is equal to the debt service that Middle Fork has on its loan from EIERA. The company now wants to include the equity in the plant, and by that I'll refer to the -- to the difference between the value of the plant and the -- and the remaining debt on it. The city now wants to include that equity in its rate base. So the company could now obtain a return on equity and a return -- a return on the equity and a return of the equity.

The company seeks to collect a second time for something that it has already collected once for by the payments that the cities have made under this surcharge, sort of like requiring a tenant to pay the landlord's mortgage. And then in addition, after the mortgage is paid off, continue to pay rent to the landlord. This plant that the cities have paid for should not be included in the company's rate base. Thank you.

JUDGE LANE: Thank you, Mr. Krueger. I have a question -- I have a quick question just to kick it off.

COMMISSIONER JARRETT: Go ahead.

JUDGE LANE: What happens if the cities didn't follow through on what you referred to as their obligation to pay?

MR. KRUEGER: If the cities did not

follow through in their obligation, the company would still be obliged to make the payments to the EIERA. There is that very small element of risk. If the cities did not pay for the water that the -- that the company delivers to them, then the company would still be obliged to the EIERA.

JUDGE LANE: Now, at the time that these -- that these financing documents were executed and these arrangements were -- were entered into, were the two cities involved, you know, responsible municipalities, was there any danger of them defaulting, you know, any danger -- you know, was there any risk there?

MR. KRUEGER: I don't -- I don't think it was perceived so. The cities noted that they were in a declining population situation and they -- and they felt like they couldn't make the payments under a traditional rate-paying method, but -- so they -- they came up with this special rate-paying scheme whereby they would pay the debt service and in addition pay for the -- for the water usage.

JUDGE LANE: So in some sense the way that this deal was structured to begin with was an outgrowth of some perceived or -- or real sense of financial weakness on -- on -- on the part of the cities involved in terms of footing, you know; is that -- is that fair to say?

MR. KRUEGER: I wasn't -- I wasn't involved in the case and so I'm -- I'm not sure that I'd say that, but I -- part of it was that if the -- if the company had financed this with its own funds, it would have had -- only with a ER -- EIERA and then done a traditional ratemaking, they would have had a 90 to ten debt-to-equity ratio. That was one of the things that -- that there was concern about, and so this was thought to be a way to avoid that.

The -- the reason why these projects were constructed in the first place was because the facilities that the cities -- cities had were inadequate and then this was just the way that they chose to finance it

JUDGE LANE: All right. Thank you. That concludes my questions. Commissioner Clayton, Commissioner Jarrett?

COMMISSIONER CLAYTON: I'm deferring to ...

COMMISSIONER JARRETT: Well, I may have some questions but I'd kind of like to hear Mr. Mitten and then I might have questions for both.

JUDGE LANE: All right. Same thing for

you?

COMMISSIONER CLAYTON: I'm -- I'm gonna wait.

JUDGE LANE: All right. Mr. Mitten, then.

MR. MITTEN: Thank you, your Honor. If it please the Commission. Let me begin my argument this afternoon by stating one irrefutable fact and that is that not one penny's worth of a plant-in-service that Middle Fork Water Company currently uses to serve its customers was contributed by anyone. 100 percent of the funds that this company used to build its plant-in-service, it raised in the capital markets. It went to the debt markets and used government-secured debt through the EIERA to raise debt capital, and it also sold equity capital to its shareholders.

It then used the capital that the company raised in the capital markets and built from scratch the plant-in-service that's being used to serve customers. It bore 100 percent of the risk of its debt and equity capital, and because it built the plant itself and bears 100 percent of the risk associated with that capital, it has a constitutional right not only to have 100 percent of that investment recognized for rate base, but also to be allowed to earn a reasonable rate of return on 100 percent of the investment that it's made.

And that's all that the company is asking for in the valuation proceeding; for the Commission to make a determination that if the company makes an investment in plant-in-service, that it's gonna be recognized in rate base and that they're gonna earn a return on that investment.

Staff has recommended that the Commission categorize 85 percent of the company's plant-in-service as a contribution aid of construction. That's just wrong. There is no legal or factual basis to support that recommendation. As we pointed out in our written response, the Uniform System of Accounts has a definition for contributions in aid of construction and that definition sets up two criteria that you have to meet in order to properly be classified as a contribution.

One, either the plant itself or the funds used to construct the plant have to come from somebody other than the company, and secondly, that capital has to be cost-free to the company. As I mentioned just a moment ago and as we've shown in our written pleading, all of the capital that was used to build Middle Fork's plant-in-service came from the company itself. It went to the capital markets just like every other company, just like every other utility does, and it raised the money that was necessary to build its plant-in-service, and that capital is not cost-free to Middle Fork.

It owes its equity investors a reasonable equity return, and on the debt capital that it raised through the sale of the EIERA bonds, it has to return -- it's contractually obligated to return both the principal and interest. And current interest rate is about 7 percent, so tens of thousands of dollars every year have to go from Middle Fork to the bondholders in order to meet its obligations under its indentures. So Middle Fork's investment satisfies neither of the criteria that are set up in the Uniform System of Accounts for contributions in aid of construction.

Now, Staff tries to divert your attention from this fact, that Middle Fork's investment doesn't meet the definition of CIAC by pointing to a couple of other things. First of all, they're saying that Middle Fork's plant -- or that the rates that Middle Fork's customers play -- pay are akin to connection charges. They're not. A connection charge is an upfront payment that a utility customer is required to make to defray the capital cost of that increment of plant that is necessary to serve the customer. It's a -- it's a condition precedent for service. There were no upfront payments made by Grant City or the city of Stanberry to Middle Fork as a condition precedent for them receiving water service. Middle Fork went out and raised the company, it built the plant, and only after that plant began operating did the cities begin paying rates for water service.

Staff also argues that because Middle Fork's customers pay as part of their cost of service base rates, debt service cost to the company, that that somehow magically converts plant investment into a contribution in aid of construction. As we pointed out in our pleading, every major utility in Missouri recovers its debt service costs from its customers, but I've never seen Staff argue for any of those major utilities that that fact converted legitimate debt financed investment into a contribution in aid of construction, and it doesn't work for Middle Fork either.

The only explanation that I can come up with for Staff's position in this case is that Staff has fallen into what I call the small company -- small water company trap. And they've set up a tautological argument where the major premise is that most small water companies are financed through contributions in aid of construction. Middle Fork is a small water company; therefore, Middle Fork must be financed through contributions in aid of construction. But that's an incorrect conclusion, and I've prepared a visual aid that I think will exhibit that fact, if I could pass those out.

JUDGE LANE: Do we need to have this marked as an exhibit or can we dispense with that?

MR. MITTEN: I don't think you need to have it marked as an exhibit, but if you'd prefer to do so, that's fine with me, your Honor.

MR. KRUEGER: It doesn't have to be marked.

MS. BAKER: That's fine.

JUDGE LANE: Make sure everybody -- do you have sufficient copies for the other parties?

MR. MITTEN: I have for most of the people here but maybe not for everyone.

JUDGE LANE: Okay.

MR. MITTEN: Certainly for counsel, I do.

Focus first on the chart where the middle box is entitled Typical Small Water Company. That shows how a typical small water company in Missouri or anyplace else is capitalized. They usually have a developer who will build infrastructure as part of a development, and then in return for the water company's promise to provide service to the homes in the developer [sic]. The developers will simply contribute, donate the infrastructure to the company. And that's shown by the arrow running from the developer to the water company. But -- but you don't see any arrows running from the water company up to the developer, and that's because there is no ongoing obligation by the water company to repay the developer for that investment.

Now, the customers of typical small water companies pay rates, and those rates include a recovery of the utility's cost of service, but because small -- typical small water companies don't have any debt costs, there is no debt service included in those cost of service base rates.

If we can go to the other chart. This shows how Middle Fork Water Company has financed its plant. There you see you have shareholders and bondholders, both of whom provided investment capital to Middle Fork Water Company which Middle Fork Water Company then invested in plant-in-service. Nobody gave the company anything.

You also see arrows going from Middle Fork back to the shareholders and back to the bondholders, and that reflects the fact that the company has an ongoing obligation, both to its equity holders and to its debt holders to provide them a return. And the debt holders are owed not only a return of the interest on their investment, but also a return of the principal, and the company is contractually obligated to make those payments.

You also see arrows running from the customers into Middle Fork Water Company. Now, again, those are cost-of-service-based rates, but because this company has debt service costs, those debt service costs are included as part of the cost of service-based rates that Grant City and Stanberry pay to Middle Fork Water Company.

I would note that this is also a diagram that shows how every major investor-owned utility in the state of Missouri is capitalized. Ameren, Kansas City Power and Light, Aquila, Laclede Gas all have debt and equity going to the company to fund its investment, and then monies flowing from the company to those sources of investment to pay them a return on the capital that they have given the company. So Middle Fork Water Company is very different than most small water companies, maybe every small water company in Missouri, and it has to be recognized as such.

And as we pointed out in -- in our written comments, if the Commission does not convert the debt finance plan of other major utilities in this state into a contribution in aid of construction simply because the companies recover from their customers debt service costs, then you can't apply that principal to Middlebury [sic]. Middlebury [sic] has to be treated like every other utility. It has a debt obligation for debt that it raised in the capital markets and whose funds it used to finance plant-in-service. It has a right to recover those costs from customers, and that does not convert that plant investment into a contribution in aid of construction.

Now, Mr. Krueger, in his argument, a couple of times said that the cities of Stanberry and Grant City don't get anything for what they're paying Middle Fork Water Company. They do. They get water service. That's all they have the right to expect. That's all any utility customer have the -- has the right to expect. As we cited in -- in our brief, it's a well-established principle of law that by paying utility rates, customers don't gain an ownership interest in the utility company. That's not different from Middle Fork.

And all customers pay debt service costs as part of their normal rates. It's -- it's a legitimate cost of service. It has always been recognized by this Commission and every other regulatory commission as a legitimate cost of service. And the fact that a portion of the total rate that Grant City and Stanberry pays is discretely identified as a debt service cost doesn't change the nature. If a customer's paying $100 a month for a utility service, it doesn't make any difference if they pay that as a $100 check or they pay it in two discrete amounts, $80 to cover operating expenses and $20 to cover debt service costs.

The reason that debt service costs were broken out discretely for this company goes back to the origins of Middle -- Middle Fork Water Company. When it came to the Commission in the early '90s and asked for a certificate of public convenience and necessity, it had no income statement, it had no balance sheet. All they had was an idea. They wanted to build a water treatment plant and facilities that would be enough to sell water to the cities of Grant City and Stanberry.

The bond -- the people that -- who ultimately bought bonds in this company needed some assurance that this company that had no assets and had no operating history was gonna be able to pay off its obligation. So as part of the contracts with the cities, the debt holders required that a portion of the monthly rate be discretely identified as debt service cost and that that be set aside so that at the end of the month or the end of the quarter, whenever the debt service payments are due, that money was gonna be available and the debt holders could easily trace that money and make sure that it was going to be there to meet the obligations.

But at the end of the day, it's completely a form-over-substance argument to suggest that discretely identifying debt service costs as a portion of an overall rate changes the nature of -- of that payment by the customers to the company.

I would also address one other argument that Mr. Krueger made. He said that if you're a landlord/tenant situation, once you pay off the mortgage, you don't have to pay rent anymore. It's obvious that Mr. Krueger's not a landlord because once you pay off the landlord's mortgage, you still have to pay rent because that's the landlord's investment, and that landlord has a right to recover a return on that investment whether he still owes any debt on that investment or not. The same principal applies to Middle Fork, the same principal applies to any other investor-owned utility that finances a portion of its plant-in-service with debt. Thank you.

JUDGE LANE: Thank you, Mr. Mitten. Any questions so far?

COMMISSIONER JARRETT: Yeah, I guess for Mr. Krueger first. I want to make sure I understand the arrangement here between the cities and Middlebrook [sic]. Had they all -- had the cities all with -- with Middlebrook [sic] agreed that Middlebrook [sic] was gonna build a plant and provide water before they went out and borrowed money and did all that?

MR. KRUEGER: Yes, it's my understanding that all of these transactions were contemplated as -- as part of one solution to a problem.

COMMISSIONER JARRETT: And -- and the city was -- before Middlebrook [sic] even went out to borrow the money to get the debt, they knew that the cities were gonna pay surcharges that would equal the --

MR. KRUEGER: That's my understanding. When -- when I describe these things, I talk to them like this happened, then that happened, then that happened. Well, actually, they all happened at the same time. I was just trying to say that in a logical sequence, the money flowed in this particular way, but it was all part of an -- of one unified agreement. And at the time that that was made, the cities were going to execute the water purchase agreements and the company was going to execute the promissory note and EIERA was gonna sell the bonds.

COMMISSIONER JARRETT: Right. So my question, Mr. Mitten, is -- to you is, is it your argument of form over substance, that basically everybody agreed that the city was gonna pay for the loan, they were gonna -- they were gonna pay the principal and the interest on the loan so Middlebrook [sic] wasn't just going out and borrowing money and then deciding, okay, now we're gonna try to -- you know, try to recover this money later? They knew up front that basically the cities were gonna -- were gonna pay for the construction by this surcharge, and isn't that -- isn't that what contributions in aid of construction is?

MR. MITTEN: No. The cities aren't paying off the loan. The cities are paying for water service. A portion of the water service rate has been identified as a surcharge to retire the debt cost. But if either one or both of the cities default on their contract, it's Middle Fork that has to pay off the bonds, not the cities.

COMMISSIONER JARRETT: Yeah. Now, does the money go -- is the money paid to the -- is the money paid to Middlebrook [sic] and then Middlebrook [sic] pays the debt, or does it go directly from the city right to the ...

MR. MITTEN: The only obligation to the debt holders is on Middle Fork.

COMMISSIONER JARRETT: Middle Fork, I'm sorry.

MR. MITTEN: The only reason that the take-or-pay contracts are written the way they are is that the people who bought the bond, the underwriters, needed some sort of assurance that the funds that are necessary to pay the debt service costs are going to be there. So they said, let's identify a portion of what these customers pay on a monthly basis as debt service costs so it's easy to trace the money that goes from the city -- the company -- or the company -- the city into the company and that the company is then going to owe us as debt service cost.

But Middle Fork is on the hook to the debt holders, the cities aren't. It has water supply contracts with the cities, but if the cities default under those water supply contracts, the debt holders don't have the right to look to the city for the payment of the principal and interest, they only have the right to look to Middle Fork for that.

MS. BAKER: Your Honor, may -- this is getting a lot of -- a lot of the parties involved and I've not been able to speak yet, so I don't feel like I should answer the questions until I've at least given my argument. May -- may I go ahead and give argument now or --

JUDGE LANE: Yeah, I -- I --

MS. BAKER: Can I -- can I jump into -- to the -- to answer?

JUDGE LANE: Sure. Why don't you go ahead and -- why don't you go ahead and kick into your argument --

MS. BAKER: Okay.

JUDGE LANE: -- and I think maybe with -- with all three of viewpoints, then we can -- then we can begin the last of it.

MS. BAKER: I appreciate that. Thank you. May it -- may it please the Commission, my name is Christina Baker and I represent the Office of Public Counsel and the ratepayers of Middle Fork.

And what Middle Fork is asking this Commission to do is to create phantom equity in a plant for which the company has no investment. The Commission is being asked to ignore the fact that the cities have already paid for the cost of this plant and to set a rate base which includes plant -- which includes this plant so that the customers will have to pay again.

Rates charged to the customers must be just and reasonable. For ratemaking purposes, contributions in aid of construction and customer advances for construction are properly deducted from the original cost rate base.

In the case Reinhold v. Fee Fee Trunk Sewer, Incorporated, the Court of Appeals acknowledged that contributions in aid of construction may not be included in the -- in the determination of rate base for ratemaking purposes. The Eastern District stated that courts' hold to do so would result in two inherent inequities: First, to allow the utilities to include these contributions in the rate base is to ask the utility customers to pay twice for the same thing.

Second, it allows the utilities' shareholders to receive a return on money for which the -- the utility never invested. A public utility is -- is entitled to a return of equity and a return on that which it has invested. Therefore, the utility is made whole in its investment.
Mr. Mitten's assertion that major utilities should receive a return of is simply wrong. Major utilities do not receive a return of monies with regard to debt service.

In this case, if we go to the chart which Mr. Mitten gave to us, the second one with Middle Fork Water Company in the middle, on this, Mr. Mitten shows rates coming from the customer and a return going to the bondholders. However, it's misleading in that the -- the arrow that goes to the bondholders is a return on the equity that was -- that was brought from the bondholders, not a return of the debt service.

In this case the surcharge is a contractual obligation which has been paid by the cities since 1992. In addition to the surcharge, the Commission approved tariff -- a tariff which includes rates paid by the cities on the remaining rate base for the water service that they receive.

Going back to the chart, an additional arrow should come from the customer to Middle Fork, and that would be the principal payment by the cities through -- through the surcharge which is a return of the equity in the amount of the EIERA loan. And an additional arrow should go directly from Middle Fork to the bondholders of the same amount of return of, for that equity. Middle Fork is, again, just a passthrough. The money goes directly from the customers through Middle Fork and to the bondholders. All equity that exists in the project has been furnished by the cities, not by Middle Fork.

And again, another arrow should be added going from the customers to Middle Fork, and this is the interest cost payments by the cities through the surcharge which is a return on the money which the company has invested. Again, this is a passthrough. Another arrow or -- we go back to the arrow that is there, that is the return on the investment. Again, Middle Fork is just a passthrough. The money that is paid goes directly from the customers. Middle Fork has no investment on the return on the debt service.

Due to the EIERA of loan and the payment by the cities, the investment by the company is zero, so the return of -- for the company itself should be zero.

The arrow that is there coming from the customer to Middle Fork Water Company is the tariff rate which was paid by the cities on the remaining rate base for the water service that they received. This includes a return of the equity in the remaining plant and a return on the money that Middle Fork has invested, and that is shown going to the -- to the shareholders.

So the -- the chart which was given by Mr. Mitten is very deceiving in that it does not show you that the return on and the return of which was -- which is based off of the bonds is just passed through Middle Fork. No investment of Middle Fork is -- is included.

Therefore, Middle Fork is -- is made whole in its investment in the utility through both the surcharge and the rates which are -- are set in the tariff. If the phantom equity were included in the rate base for determining rates and paid for by the cities, Middle Fork would receive a double recovery and would receive a return on money for which the company never invested. This would be the exact inequity which the Eastern District points out as why funds like these contributions in aid of construction should not be included in the rate base. Thank you.

JUDGE LANE: Thank you, Ms. Baker. Okay. I think we've heard at least the --

MS. BAKER: Thank you.

JUDGE LANE: -- the initial salvo from everyone. Commissioner Jarrett, if you would like to continue your ...

COMMISSIONER JARRETT: Well, I -- yeah. Ms. Baker, so you would -- would you agree that OP -- OPC's position is that this is a form-over-substance, that Middle Fork has structured this like a typical utility transaction, they borrow money, they build the plant?

MS. BAKER: It is not a typical situation in that --

COMMISSIONER JARRETT: Right.

MS. BAKER: -- in that where -- where

the company goes in, they put in their investment into the -- into the utility and then after the fact they come to the Commission and ask for a return of their equity and a return on their investment through the rates.

In this case, Middle Fork is getting the payment of their debt, of the bonds. They're getting that paid for directly by the cities. They are not investing anything in the system at all. It just passes through their hands directly. And that's why in this case the bond equity is -- or the bond principal is being paid by the cities. It is not being paid by Middle Fork. Middle Fork has put none of their money in.

COMMISSIONER JARRETT: Okay. Mr. Mitten, do you have any response to OPC's argument that she disagreed with your debt service argument?

MR. MITTEN: Every utility finances a portion of its plant-in-service with debt, but for no other utility have I ever seen Staff or Public Counsel argue that the debt finance plant wasn't rate-based and wasn't entitled to a return. The return of capital that Public Counsel talked about during her argument, she is mistaken. That's --

we're not talking about a return of the principal on debt. When the courts talk about a return of capital, they're talking about depreciation. Even contributed plant is entitled to receive depreciation through rates. It's -- it's the recovery of the value of plant when it has to be replaced.

What we're talking about here is the recovery from customers of the principal and interest cost of debt. Every utility gets to recover that through its cost of service rates, but Middle Fork is the only utility I'm familiar with where Public Counsel and Staff have argued that that fact converts legitimate investment into CIAC.

The difference between a large utility and Middle Fork is that when Ameren goes to the debt market and wants to borrow a quarter million dollars, it has a huge balance sheet, it has a huge income statement so the potential bondholders can see what the coverage ratios are, and they gain some security from that. So they don't require that Ameren identify a portion of the rates that it receives from its customers as debt service costs to cover the debt -- or the principal and interest that it's gonna have to pay on its bonds. Middle Fork was a completely different situation.

But in Ameren's case, when you include the embedded cost of debt in calculating the overall rate of return that a utility is entitled to, and then you multiply that overall rate of return by the value of rate base which includes not only equity-financed plant but also debt-financed plant to come up with an overall revenue requirement for the company, you are, in effect, allowing through rates the recovery of principal and interest and you are recognizing in your rates that debt-financed plant is, indeed, a utility investment that is entitled -- excuse me -- to earn a return on.

Now, regulatory commissions have traditionally limited the return that can be earned on debt-financed plant to the coupon rate on the bonds. You don't get to earn an equity return over and above what you have to pay the debt holders, but you do get to recover the debt service cost through rates. And again, for all other utilities, that doesn't convert their plant into CIAC. It shouldn't convert Middle Fork's either.

MS. BAKER: If I may, but you don't get to also charge a surcharge where that debt is being recovered as well.

MR. MITTEN: And Middle --

MS. BAKER: What they are asking for -- I let you speak. When -- when they are asking for this Commission to come in and say we want to put this into rate base when it has already been recovered through the surcharge, they are asking this Commission to make the customers pay twice. You can pick one or the other, but you cannot pick both --

MR. MITTEN: But --

MS. BAKER: -- and it is wrong to say that the public -- that Office of Public Counsel has never -- has never taken CIAC into -- into any of the cases before. This Commission has -- has taken into account connection charges, we have -- have dealt with CIAC in several other cases, but never is it -- is it proper to have the customers pay twice for the same thing and call this being -- to be just and reasonable rates.

COMMISSIONER JARRETT: Has the Commission ever had a case with similar -- similar facts come before it?

MR. KRUEGER: Not that I know of. It --

MS. BAKER: Not similar facts but certainly ones where contributions in aid of construction that has been paid for by another entity has been removed from rate base. That -- that is a fairly common situation, and I can -- I can quote you cases that have gone up to the Supreme Court where that -- that very issue has been acknowledged.

COMMISSIONER JARRETT: Right. But I guess -- I guess the issue is -- or one of the issues is whether or not this is contribution in aid of construction. I take it, Mr. Mitten, you would say no?

MR. MITTEN: It's not. The Fee Fee case begs the question. This is not a contribution in aid of construction. Middle Fork is not arguing that contributions in aid of construction should be allowed in rate base. What Middle Fork's saying is it doesn't have any contributions in aid of construction.

And if I can address Public Counsel's argument, yes, this Commission has heard these kinds of cases. Every time a major utility comes before you with debt-financed plant, you're hearing this issue. And -- and we're not asking for customers to pay for anything twice. What I'm saying is, if the Commission decides that the cost-of-service-based rate for the water service that Middle Fork is providing is $100, and that includes operating costs, a return on equity and a recovery of debt service cost, we're not asking for that plus a surcharge. We're simply saying of that $100, you identify 80 of that as operating costs and 20 percent of it gets discretely identified to recover debt service cost.

So there's no double collection here at all. In the normal utility situation, because the debt holders have not required either the utility or the Commission to discretely identify a portion of the rates as debt service cost, you simply say $100, and a customer writes one check for $100 instead of one check for $100 that gets broken into two buckets, $80 for operating costs and $20 for debt service.

COMMISSIONER JARRETT: So is what you're saying is that if you-all construct your -- your rates where there was no surcharge and it was gonna be a hundred bucks, we wouldn't be here today, but since you guys split it out 80/20 --

MR. MITTEN: Well, I think --

COMMISSIONER JARRETT: -- to use your example, that that's why we're here today?

MR. MITTEN: I think that's part of it. I think the other part is Middle Fork may be unique as a small water company in being financed the way it is. The chart that I showed you is the typical way a small water company is financed. Somebody gives it, either the infrastructure that it uses to provide service or gives it the funds that it uses to build that infrastructure. Nobody has given Middle Fork anything. It's simply through its water service rates recovers its cost of service from its customers, and a part of that cost of service is debt service.

Another part of that cost of service is the return of capital which is the -- which is what Public Counsel was talking about, and that's through depreciation rates.

COMMISSIONER JARRETT: Mr. Krueger, you've been kind of quiet for a while, so I thought you might have some rebuttal you might want to --

MR. KRUEGER: I do, I have a lot of things. I won't -- I won't tell them all, probably.

First I'd like to talk about this chart that Mr. Mitten provided, and the one I'm talking about is the one that has Middle Fork in the middle. And he shows there in the upper left-hand corner a blue arrow going down toward Middle Fork from the shareholders and a red arrow going back to the shareholders. In essence, that's a -- that's an exchange. The shareholders invest money and in exchange they get a return. It's like the consideration.

Similarly for the bondholders in the upper right. I would make one change to the situation with regard to the bondholders in that actually the -- the payment that Middle Fork makes is not to the bondholders, it's to EIERA. And so there's a separate step in there that goes to the bondholders -- I mean, it goes to the EIERA and then -- and then bondholders are -- are the next step.

He simplified it by showing directly from Middle Fork to the bondholders, and that might be similar to the situation that I'm talking about where -- where the ratepayers are -- I mean the cities are essentially paying it to the EIERA. He's -- he's simplified, taken -- taken out one entity here because it just passes through, and that's essentially what is done with the money that the cities pay.

But basically, to make these -- these charts work, you need an arrow going in each direction. There has to be consideration. One party does -- does something and gets something back.

And in the bottom part of the chart, the thing that I would -- I would disagree with is he shows a one-way arrow from the customer, Grant City, to -- to Middle Fork but nothing going back. Well, the thing that goes back is water, is water service. So there -- there should be arrows going in each direction, one is in exchange for the other.

And in this case, the way we see it, the -- the -- the rates, the water -- the usage charge is to compensate the company for its operational expenses including a return on equity. But then in addition to that, there is one other arrow that goes from the customer to Middle Fork, and that is the surcharge. And that's why I say they don't get anything for what they -- for the surcharge. The water usage charge pays for the cost of the water. That's already been paid for.

And then in addition, they make -- they make the payment of the surcharge, the debt service, and now the company wants to say that it's -- that it's -- that they have all of that equity.

JUDGE LANE: Well, isn't this the situation that we've got here? It seems to me that it's almost sui generis. I mean, it's not really like a connection charge, it's not really like double-paying your rent. I mean, those are some constructs that we can kind of get our mind around, things that we're familiar with, but it seems to me like we're dealing with an animal here that doesn't -- I mean, you know, you've been -- I don't think anyone here has ever had a case like this. And maybe -- maybe somebody remembers from the distant past.

MR. MITTEN: Yeah, this is -- this is no different than any large rate case.

JUDGE LANE: Well, let me put it this way: Nobody's had a small water company case anything like this, and maybe --

MS. BAKER: Well, there -- there are EIERA loans that go through these water and sewer companies all the time. The Commission has dealt with those in many cases. And so the debt service that goes through, you're right. In a typical water system, the company would invest something and then they would seek to retain it back from the customer, but in this case nothing has been invested from the company, so it does make it different from the typical. And -- and you can't -- you can't add something into -- into rate base without having some kind of an investment from the company to balance that out.

MR. MITTEN: Your Honor, every utility

that uses debt to finance its plant-in-service makes a debt-based investment. Every utility gets that debt-based investment recognized in rate base, and every utility that makes a debt-based investment gets to recover debt service cost through rates. Middle Fork is no different than any other utility. It may be different than any other water company, but it's no different than any other major utility operating in Missouri or anywhere else.

MS. BAKER: But there's another choice that the company had and that was the one that they took, which was to get a surcharge and get that paid for directly by the city. That was a choice that the company took. They decided to go that route instead of putting it into rate base. They can't have both.

MR. KRUEGER: Your Honor, Mr. Mitten says that every major utility recovers debt service from its customers in its rate base, and he's -- he mentioned specifically Ameren and KCPL and Laclede, and I agree that those companies do recover their embedded cost of debt and their return on equity in the rate base, but they do not get to impose a separate charge upon the customers to -- to pay all of the debt service in addition.

COMMISSIONER JARRETT: Yeah, I don't

have any other questions.

COMMISSIONER CLAYTON: Can I go now, Judge? Would that be all right?

JUDGE LANE: Yes, please.

COMMISSIONER CLAYTON: Good. Okay. All right. I want to get a few facts straight in my head, and I'm not -- I'm not sure if I understand this. First of all, there are two charges that are at play. There's a -- there's a user charge and then a surcharge; is that correct?

MR. KRUEGER: Correct.

COMMISSIONER CLAYTON: Whoever. I mean ...

MR. MITTEN: It's one cost-of-service-based rates that's broken into charges. It's not two -- it's not an add-on.

MS. BAKER: I -- I would disagree with that.

MR. KRUEGER: I believe it's two separate checks are written or there's a separate --

COMMISSIONER CLAYTON: There's just two charges. Aside from what it is -- just bear with me. We've got two charges. We've got a user charge and a surcharge is what I wrote down. Is that -- would you agree that there are those --

MR. MITTEN: Yes.

COMMISSIONER CLAYTON: -- two charges built into the rate? Now, the -- it's a -- actually, it's a usage charge. Now, which one is the debt, this -- this -- this debt payment charge?

MR. MITTEN: Surcharge.

COMMISSIONER CLAYTON: That's the surcharge. And that pays just 100 percent of the debt expense, correct?

MS. BAKER: And -- and principal, by the way, and principal.

COMMISSIONER CLAYTON: Yeah, yeah. Now, the usage charge, what is that based on?

MR. MITTEN: It's based on all other cost of service elements except for debt service.

COMMISSIONER CLAYTON: All other cost of service elements.

MR. MITTEN: Operating expenses, administrative expenses, return on equity, whatever else the Commission believes is appropriate.

COMMISSIONER CLAYTON: What -- okay. What -- return on equity of what?

MR. MITTEN: Whatever the Commission allows.

COMMISSIONER CLAYTON: Okay. Well,

let's talk about whatever's in this rate right now. You've got all other cost of service items, and I've got -- you've got your expenses, you've got your administrative expenses, all that is an expense. You don't get a return on any of that, you just get a return of that. So what -- what is built into that usage charge that you would get a return on equity?

MR. MITTEN: There's probably no return on equity at all built into the current rates. So that's --

COMMISSIONER CLAYTON: Okay. So there's -- so you miss -- there's no return on equity.

MR. MITTEN: Well, it should be, but the last time the company came in for a rate case, it asked for a $50,000 rate increase. The Staff by its own analysis said the company was entitled to more than that, but the company said, we're gonna settle for $50,000 because that's the deal we've negotiated with the cities.

COMMISSIONER CLAYTON: Okay. Okay. So this usage charge is basically made up of a bunch of expenses?

MR. MITTEN: Yes.

COMMISSIONER CLAYTON: And those are

ongoing annual expenses associated with Middle Fork, correct?

MR. MITTEN: Yes.

COMMISSIONER CLAYTON: Okay. So -- and this -- this company was formed in, what, '91, '92?

MR. MITTEN: Yes.

COMMISSIONER CLAYTON: All right. And the contracts, Grant City was in '91 and the contract with Stanberry was in '92, so February 12th, 1992. Well, both -- there was a second contract to Grant City. Anyway, '91, '92 is when all this started, right? Every -- anybody dispute that?

MR. KRUEGER: I think they were all pretty much simultaneous.

MR. MITTEN: I think they started simultaneously. The contracts themselves may have been signed at different times, but neither Grant City nor Stanberry started paying for water until the facilities were constructed and the company began producing.

COMMISSIONER CLAYTON: Yeah. Well -- yeah, I was just -- the contract dates -- there were two contracts for Grant City and one for Stanberry and that -- I don't know if it's that important. So at the time Staff approved of the certificate, that occurred in '91 or '92, Keith?

MR. MITTEN: Correct.

COMMISSIONER CLAYTON: Okay. And --

MR. KRUEGER: Yes.

COMMISSIONER CLAYTON: Okay. And how were -- how were rates set back at the inception of this, do you recall? Is that -- I didn't see that in -- I didn't review every pleading that was filed in this case, but --

MR. KRUEGER: Okay. I'd like to read from a letter that the mayor of Grant City sent to Middle Fork Water Company in 1991. One part of it he said, "Grant City and" -- this is his understanding of the agreement: "Grant City and Stanberry will share rates equal to the annual cost to retire the bonds or about $180,000. At the time the bonds are paid, this should drop to about $20,000 annual payment."

It was definitely his understanding that at the time the bonds are paid off, the company would no longer be including this plant in the rate base in recovering the cost of that from the -- from the company. The rates at that time were sent -- set at $1.06 per 1,000 gallons. They've since been raised. I think in the last rate case it was set at $1.33.

MR. MITTEN: Commissioner, what that letter reflects is that when the bonds are paid off, there will no longer be any debt service costs, but the investment still gets to be in rate base.

COMMISSIONER CLAYTON: Is that -- is that letter in the record?

MR. KRUEGER: It is not in the record. It's -- it was filed in -- it's attached to the Staff's memorandum in Case No. WA-8265.

COMMISSIONER CLAYTON: Okay. So it's in the record. It's in EFIS.

MR. KRUEGER: Well, not -- not in this case, but it was in the certificate case.

COMMISSIONER CLAYTON: Oh, in the certificate -- well, yeah, so -- but it's something we can look at.

MR. KRUEGER: It is a -- it is a Commission record, yes.

COMMISSIONER CLAYTON: Okay. So going back to '92, how were rates set when -- when the certificate was granted?

MR. KRUEGER: The Commission's order granting certificate says, "Both cities have agreed to take or pay contracts which are priced in such a manner that the cities will pay for all ordinary expenses incurred as determined by traditional ratemaking as well as all expenses that are related to the long-term debt issuance above and beyond the traditional recovery of interest expense."

So the Commission there made it clear that that was a -- that was over and above the ordinary ratemaking --

COMMISSIONER CLAYTON: I understand, I understand. Just help me get some preliminary facts here. Everybody is arguing their case. I -- I just want to get an idea of how rates were set. You said that they're gonna pay the debt on the one hand and then they're gonna use traditional ratemaking on the other. If they're gonna use traditional ratemaking on the other, what was included in that? The little bit of expense and no rate base?

MR. KRUEGER: I -- I don't think there was --

COMMISSIONER CLAYTON: I mean, was there ever supposed to be rate base?

MR. KRUEGER: I think there might have been a little rate base. I think that -- I have a document here that indicates the company will invest 10 percent, and so I think there might have been -- might possibly have been some return on equity, but

I'm not positive.

COMMISSIONER CLAYTON: Okay. How many rate cases have there been since 1992 for this company?

MR. MITTEN: Two.

COMMISSIONER CLAYTON: Two rate cases. What years would have those been?

MR. MITTEN: Excuse me, just one.

MR. KRUEGER: It was the 2006 --

MS. BAKER: The tariff has it like 2005 was the effective date of the change.

MR. KRUEGER: That's about right.

COMMISSIONER CLAYTON: Okay. And was there any rate base then that was earning a return -- well, I mean, those are the current rates, right? And we don't know if there's any rate base in that.

MR. MITTEN: Well, in the Staff's analysis in that case, they characterized about 85 percent of the company's plant-in-service as a contribution in aid of construction, but they still said that the company deserved more than it was asking for. So the issue was really kind of academic at that point. Based on Staff's analysis, there was no rate base, but the company still got the full amount that it had asked for. That's why we're here today, because we need to get that point cleared up so the company can know --

COMMISSIONER CLAYTON: Because the debt service is gonna end, that surcharge is gonna end from the cities; is that right?

MR. MITTEN: No. It's because the companies --

COMMISSIONER CLAYTON: Wants to do the expansion.

MR. MITTEN: Well, it's -- it's possible to expand outside its service area and also it's got some additional investment that it's going to need to make inside the service area and it needs to find out how its debt finance investment is gonna be treated for ratemaking service.

COMMISSIONER CLAYTON: I mean, I don't know if this is the right way to look at this, but I mean, I tend to -- there are parts that I agree with on both sides of this issue. I understand what the company is saying in terms of raising capital in the manner that it did, and if you look at it purely from that side, the debt comes in, that -- that amount of capital goes into the plant, you invest it and eventually get a return on equity. But the rates were never set up that way. The rates were set up completely different.

MR. MITTEN: The rates have probably been under cost since the beginning and I think it reflects the nature of what Middle Fork provided to these cities. The cities were declining in population. They needed a new water supply. White knight -- or excuse me, Middle Fork basically came in as a white knight to -- to build the treatment facility and the infrastructure that was necessary to provide water to these two cities that it could then resell through its municipal distribution system.

And the company has never made the amount of money that it should have been, but we need a determination from the Commission going forward as to how this company's legitimate investment is gonna be treated.

COMMISSIONER CLAYTON: Okay. Let me ask this question. If any of this is highly confidential, so state and we'll figure out how to deal with it. What is -- what is an approximate amount of Middle Fork's plant-in-service, gross plant-in-service --

MR. MITTEN: A little over $2 million from the latest annual report.

COMMISSIONER CLAYTON: A little more

than 2 million?
MR. MITTEN: Yes.
COMMISSIONER CLAYTON: Okay. And then you subtract off that depreciation, accumulated depreciation, right?
MR. MITTEN: Yes.
COMMISSIONER CLAYTON: What would that amount be?
MR. MITTEN: According to the most recent annual report, the net plant is about a million five.
COMMISSIONER CLAYTON: So half a million would be -- would be depreciation?
MR. MITTEN: The gross plant is 2,057,207, accumulated depreciation is 558,845, for a net of 1,498,362.
MS. BAKER: And if I may, there -- there are very similar numbers in Staff's recommendation.
COMMISSIONER CLAYTON: Okay. So the company's position -- I assume the company's position is that that that 1.498 million is what ought to be rate base?
MR. MITTEN: Yes.
COMMISSIONER CLAYTON: And Staff says you should subtract off one -- roughly 1.3 million to

get down to 217,000, I think. So you've got a rate base of 217,000?

MR. KRUEGER: Correct.

COMMISSIONER CLAYTON: Correct. To subtract off the -- the -- the contribution in aid of -- the CIAC, whatever. Now, if -- if we go back to 1992, and let's assume that rates would have been set traditionally where you've got the -- the debt capital comes in, the 80 percent comes in and the 20 percent comes in, you've got a total amount invested of two point something million dollars, roughly, I'm guessing at that time.

And traditional ratemaking would take all of the expenses, and then you'd have a rate base which would be roughly that amount, that -- a little over $2 million, wouldn't be much depreciation, you take it times the return on -- the rate of return component and that's how you would normally set rates under traditional methodology.

MR. KRUEGER: Correct.

COMMISSIONER CLAYTON: Anybody dispute that? Because I can easily make a mistake here, it's really easy for me to make a mistake.

MR. MITTEN: No.

COMMISSIONER CLAYTON: So that's what

generally happens, but that did not happen in this instance. What happened instead was that there was a component of expenses and then a component of 100 percent of the debt service, correct?

MR. MITTEN: Well, it should have come out to the same answer, it's just it was discretely identified as debt service and operating expenses --

MS. BAKER: No --

MR. MITTEN: -- other cost of service items.

MS. BAKER: No, because -- because the customers were also paying principal on the loan itself. They were paying more than just --

COMMISSIONER CLAYTON: Well, yeah, but the customers would have paid principal through -- through the return of the -- of the -- of the investment in the -- in the rate base component.

MS. BAKER: Right.

COMMISSIONER CLAYTON: They would have been -- they would have been contributing towards that in the formula anyway. I just don't know how that number would compare with -- with a -- you know, paying back 100 percent of the note.

MS. BAKER: It came at the beginning instead of waiting for it to come back to the company through rates.

MR. MITTEN: No. There was no upfront payment --

MS. BAKER: The --

MR. MITTEN: -- by anybody other than Middle Fork.

MS. BAKER: The amortization --

COMMISSIONER CLAYTON: Well, under this -- hang on -- hang on just a second. Under this mechanism based -- well, what is the term of the bonds?

MR. MITTEN: 20 years.

COMMISSIONER CLAYTON: 20 years. And what is the normal -- what -- what would -- what would you say the average life expectancy of this type of plant is? What would it be depreciated -- depreciated over?

MR. MITTEN: Well, some water plants --

MR. KRUEGER: 2.95 percent depreciation on the plant.

MR. MITTEN: Yeah, there's a -- there's lengthy depreciation on the water plant.

COMMISSIONER CLAYTON: Say that again.

MR. KRUEGER: 2.95 percent depreciation, that's of the total plant --

COMMISSIONER CLAYTON: 50 years?

MR. KRUEGER: -- so that would be about 30 years.

COMMISSIONER CLAYTON: 30 years. Okay. So -- so under traditional ratemaking, all things being equal, it would take that amount -- that amount of time to get back the full investment in the plant, right?

MR. MITTEN: Through depreciation, yes.

COMMISSIONER CLAYTON: Through -- and that's -- that's what traditional ratemaking does, you get back your -- your investment through that accumulated depreciation.

MR. MITTEN: That would take your rate base down to zero on a net basis, yes.

COMMISSIONER CLAYTON: Right, right. I mean, you're getting your expenses but you're getting your -- you're getting that capital back in that manner. So this way, the way these rates were set up is that basically you get all that back in 20 years rather than in 30 years. Would you agree with that?

MS. BAKER: Yes.

MR. MITTEN: Most bond issues are -- are different. The -- the duration of the bond issue is different than the duration of the depreciation on the plant to which it applies.

COMMISSIONER CLAYTON: Say -- say that again. I'm ...

MR. MITTEN: Bond issues are not tied to the depreciable life of the property.

COMMISSIONER CLAYTON: I -- I -- sure, I agree with that.

MR. MITTEN: So you're never gonna get an exact match in this case. Yeah, there is -- I think it's closer to 35 years in terms of the fully depreciated plant rather than 30 years. So there is a period of time, about 15 years, when the -- the note's gonna be paid off but the plant is not gonna be fully depreciated.

MS. BAKER: If you think about the -- the depreciation reserve, that -- that gives a -- a set of money for the company to use. They can use it to invest back, they can use it to borrow against. It is -- it is money that they have available to them to use under the -- under -- under the traditional way.

MR. MITTEN: And that's why rate base is net of accumulated depreciation.

COMMISSIONER CLAYTON: Right, I follow you.

MS. BAKER: But under this way, the amount of money that is coming back is accelerated and the company has no investment in it.

MR. MITTEN: And they -- the full benefit of that accelerated recovery -- well, the debt service cost stops at the end of 20 years.

MS. BAKER: Right.

COMMISSIONER CLAYTON: Right.

MR. MITTEN: Because --

COMMISSIONER CLAYTON: Hang on, hang on, hang on. Now -- we're gonna walk through this now.

MR. MITTEN: -- the cost of service base rates, all things being equal, will be less in year 21 than they will be in year 20.

COMMISSIONER CLAYTON: Now, help -- I'm trying to think through this because this -- this is an odd circumstance. I'm the one to blame for this, I think, on the record. I don't know if you can blame -- no one else is here, so -- I mean, I didn't mean to say no one else is here, they've been in and out, since you're typing on the record.

In theory -- in theory, let's just assume that you've got plant that has a 30-year life, okay, and let's take $2 million, that's the figure we're talking about here. $2 million is invested at the start of the plant, rates are -- are set with expenses plus the rate base times your -- your return on equity and you go 30 years. No additional plant investments.

So at the end of 30 years, in theory, what ought to happen with rates is that in year 31, rates are based on expenses plus the return -- the rate of return times zero, and basically there is no return. And that's generally what happens with small companies.

MR. MITTEN: That's correct.

COMMISSIONER CLAYTON: That -- that you -- that basically the rate base drops down to zero, they have a zero book value and -- and you're only entitled to your expenses. And then what happens is the water department tries to figure out some way to keep people interested in the plant. I mean, it's -- it's very common.

So in this instance what we've got, so it appears, is that all that return has come in in 20 years, so in year 21 what the company is asking is that even though all that capital's been returned in year 21, instead of dropping rate base down to zero or down to a minimal amount which would be just expenses, that we'll start over with a new rate base component, and rates in year 21, instead of being expenses plus zero, will be expenses plus the rate of return times $1.5 million. Now, tell me -- tell me why that is appropriate.

MR. MITTEN: Well, as you depreciate the plant over the 20 years that you're collecting interest on the note, the blended rate of return that you're earning on that rate base is a blend of the embedded cost of debt plus the return on equity.

COMMISSIONER CLAYTON: Uh-huh.

MR. MITTEN: Once the note gets paid off, you will have a net plant balance that reflects accumulated depreciation over the first 20 years of that plant life, but the only rate of return that will be applied to that would then be an equity return, it wouldn't be a blended return.

But let's assume for purposes that -- that you've -- you've depreciated. You only have 60 percent of the value of your plant. That equity return only gets applied to the 40 percent of the plant, the net plant balance that remains. It doesn't get applied to the full value of the plant that was undepreciated. But that's the way it works for any utility. Any major utility, once they finish paying off their debt to the extent that there is still undepreciated plant, then that converts to an equity return.

COMMISSIONER CLAYTON: Well, but what -- where I'm struggling with that is that a larger utility, their debt is not gonna be -- I mean, the -- the depreciation and the debt don't -- don't match. Here --

MR. MITTEN: It really doesn't match here either.

COMMISSIONER CLAYTON: And you've got revolving debt -- revolving facilities and you don't have it as clear as where you have basically one loan that went in and -- and funded 80 or 90 percent of this investment, and it's easily -- easy to track, I mean ...

MR. MITTEN: Well, but the fact that it's not easy to track with a large utility doesn't change the principle.

COMMISSIONER CLAYTON: Their rates aren't based on the cost of debt, though.

MR. MITTEN: Sure, it is.

COMMISSIONER CLAYTON: I mean, the -- the -- the weighted average --

MR. MITTEN: The overall -- the rate of return that you apply to rate base to come up with a revenue requirement is a blend of the embedded cost to debt which is their debt service cost plus a reasonable return on equity.

COMMISSIONER CLAYTON: I agree, but -- but that's only a small portion. 100 percent of this debt service includes -- includes a big chunk of principal which is not built into that component.

MR. MITTEN: Sure, it is.

COMMISSIONER CLAYTON: It's not built into that rate, it's not built into the -- the percentage that -- the interest rate or the -- the -- the cost of that particular capital. That's put into a different component in the rate base calculation. That principal doesn't go into -- I mean, there are two different parts of the debt. There's the -- there's the interest and then there's the principal. In those instances, say, if Laclede or Ameren, that principal, they're not getting that return in the same fashion; they're getting it through a different ratemaking component, aren't they?

MR. MITTEN: No. I think they're still getting it in the embedded cost. They're still getting it through rates. They're getting principal and interest through rates whether it's in different components or one component. But Middle Fork is not asking to be treated any differently than any other utility in terms of the return of its debt investment, debt-based investment.

COMMISSIONER CLAYTON: What is the rate specifically, what are these two rates right now?

MR. MITTEN: Which two rates?

COMMISSIONER CLAYTON: The usage charge and the surcharge, how are they based right now?

MR. MITTEN: Well, the surcharge is based upon the -- the principal and interest charges that are due to the bondholders.

COMMISSIONER CLAYTON: How much is that, do we know?

MR. MITTEN: About $15,000 a month.

COMMISSIONER CLAYTON: A month.

MR. MITTEN: Uh-huh.

COMMISSIONER CLAYTON: Times two or just 15 total?

MR. MITTEN: Total.

COMMISSIONER CLAYTON: Okay. Okay. And then the usage charges is what times how many gallons?

MR. MITTEN: The total that they get from usage charges is ten or $11,000 a month on average for both customers.

COMMISSIONER CLAYTON: How would that break down to, say, a price per 1,000 gallons, or is there a unit that you could easily identify?

MR. SPOSE: The usage charge is $1.53 and --

COMMISSIONER CLAYTON: Does anyone know?

MS. BAKER: The tariff rate for -- for the 1,000 gallons per month is a dollar -- 1.327 per 1,000.

COMMISSIONER CLAYTON: 1.327.

MS. BAKER: Per 1,000.

MR. SPOSE: And the debt service charge would be around $1.50 or somewhere, give or take.

COMMISSIONER CLAYTON: Now, let me ask Staff and Public Counsel this, okay? This $2 million investment in the way this mechanism is set up, the rates return this -- this investment in 20 years rather than in 35 years, would you all agree with that?

MS. BAKER: Yes.

MR. KRUEGER: Yes.

COMMISSIONER CLAYTON: Okay. Now, that's the upside, but it seems like there's a down side for company in the way this is set up because the company doesn't receive -- the way this is set up, they didn't get that big, fat rate base at the very beginning, they didn't have a rate base component of $2 million to take times 10 percent or, you know, whatever the -- the weighted cost of capital is, you know, take it times 9 percent.

MS. BAKER: Right. They did not invest anything into the rate base, that's correct. Usually when -- when we're dealing with traditional ratemaking and you're building a million-dollar plant, the company comes in, they find the financing for the million dollars, they invest into the million-dollar plant.

COMMISSIONER CLAYTON: Okay. Let me -- let me --

MS. BAKER: This way it passes through.

COMMISSIONER CLAYTON: Yeah, I know. I know that's what you're saying. Now, let me -- I mean, I follow the arguments here, just work with me. Let's say I want to -- I'm gonna open up this utility, it's gonna take $1 million -- take $2 million to do this. I don't have $2 million in my bank account. On the record I will say that truthfully, I don't have $2 million in my bank account.

So I go to Central Bank and say, I want

to borrow $2 million, and they say, you look like a swell guy, we're gonna loan it to you. So I get that $2 million and I take that and invest that, okay, and I -- I develop the plant. Now, I then come in -- or I -- and say all at the same time. I come in, go to the Staff and I want to get a Certificate of Convenience and Necessity and I want to set up these rates, all right?

Now, I'm gonna come in, I'm gonna say $2 million is my investment, I want to set up rates based on that. Here are my expenses, here is my cost of debt. Now, granted, the cost of debt is the same thing as the interest rate that the -- that the bank is charging me. We don't have to do a -- an ROE because there -- frankly, at this point there is no equity, but your weighted cost of capital is that interest rate from the bank, and rates are based on expenses plus rate base times that return on equity and that's what the customers pay. And -- and that rate base works down over time with -- with the -- you know, accumulated depreciation building up, that money comes back and it has a return on equity component -- component.

Now, is that appropriate? Can I do that if I do 100 percent financing? Can I go to the bank and borrow that money and invest that and -- and place that $2 million in rate base? Why can't I do that and get a return on that -- on that investment?

MS. BAKER: On the typical -- typical ratemaking?

COMMISSIONER CLAYTON: My example, yeah, traditional ratemaking.

MS. BAKER: May I have him --

COMMISSIONER CLAYTON: Why don't you swear him in.

MS. BAKER: It may be easier on me.

COMMISSIONER CLAYTON: It will be faster anyway.

(The witness was sworn.)

JUDGE LANE: Thank you very much.

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Mr. Trippensee.

A. Yes, Commissioner.

Q. Tell me why -- tell me if that's possible, the way that scenario that I just set up with -- with me borrowing from the bank and -- and investing that way.

A. That money would be -- the $2 million in plant-in-service would be recorded as original cost plant-in-service on the company's balance sheet. And on the liability side of the balance sheet, there would be $2 million of debt with no equity.

Q. Right.

A. So effectively, when you go in and do your rate case on day one, you would synchronize your plant-in-service which has no accumulated depreciation with your capital structure which is entirely in that situation debt, so you would have a -- an equal amount, and your cost of -- interest cost built into your rate calculation would equal whatever your financing rate is at the bank times $2 million.

Q. Right, right, right. Now --

A. Now -- go ahead.

Q. Okay. Go ahead. No, keep coming, keep coming.

A. Now, after one year, say, you will calculate interest expense -- or I mean, depreciation on that plant-in-service. That will come off of -- and let's say, 40 years, just to make life simple here, that would be $50,000 of depreciation expense in year one. So year one would -- at the end of year one, you would have net plant-in-service in this case equal to rate base of $1,950,000.

If they had $2 million outstanding of

debt still and made no principal payment, in traditional ratemaking they would only get interest expense equal to $1.95 million times whatever the coupon rate is on that debt. That additional interest expense on the $50,000, if they chose not to use $50,000 of depreciation to pay down the note, they would have to come up with that money that is outside of the traditional ratemaking process.

Q. So rates wouldn't return -- rates in -- under the traditional mechanism wouldn't return the full amount of what the debt service would be?

A. It would -- it would be dependent upon -- in that situation if they did -- they would have $50,000 in their pocket of depreciation expense --

Q. Yeah.

A. -- and they would have $50,000 of debt that they could either use some of that 50 -- they could either pay it off with the 50,000 or use that 50,000 to pay the interest expense and pocket the balance until at some point in the future because depreciation expense is a noncash expense. You don't have to give that 50,000 of depreciation to anybody.

The problem that's developed here is -- or in any of these situations is you have depreciation rates which is the -- as Mr. Mitten alluded to, the traditional big company way of getting money back to the company. They could either reinvest that in the company, they can pay it out in dividends and borrow again. There isn't a dollar-for-dollar relationship like Mr. Mitten's inferring.

The problem you've got with the EIERA is you have -- the principal payments are paid by somebody, in this case the customers, to Middle Fork. Middle Fork can then, in turn, pay the EIERA who pays the bondholders. Those principal payments are faster than the depreciation rates which I think somebody alluded to, 35, 40 years.

You create a situation that the company's investment, if you go through all the calculations on the books, you do not create equity through this process, going back to my original analysis where I talk about the one -- the first 50 million of depreciation. That didn't create new equity in this company. The bottom line is, there is no equity when you finance with debt. You can't create it after the fact. It's not gonna happen.

I -- your -- your discussion about the 20 years earlier, that when the bonds were paid off in year 21 the rates would go down, with -- through the surcharge, the -- the customers have paid the full $2 million at the end of 20 years. What Mr. Mitten's inferring is then you're gonna get to pay another million five or a million four over the next 15 to 19 years of that depreciation. That is double recovery.

I will tell you it doesn't address the problem of small companies having to access the capital markets, but it -- I don't think the courts allow, as Ms. Baker stated, you can't require the customers to pay for plant twice.

But I could -- I'd be happy to go through the entire double-entry accounting system, but to generate that million and a half dollars of rate base, they're gonna have to show that they have a million and a half dollars of equity invested in this company.

Q. When I -- when I made the point that the debt service returns the money earlier than, say, 30, 35 years of depreciation, even if it returned it at the same time, it still doesn't create equity, I think is what you're saying.

A. Exactly.

Q. Even if it were 35 years, it would -- it still wouldn't create that --

A. It never creates that --

Q. You'd still have zero --

A. Not from an accounting standpoint, it does not create equity because depreciation expense is an expense. It creates cash, it does not create equity.

COMMISSIONER CLAYTON: This goes well beyond accounting I and II that I took in college.

From Public Counsel's point of view, what should have happened in terms of rates? If we go back and we could have fixed this dispute now, what should have happened in 1992 when rates were set?

MS. BAKER: A decision could have been made at that point that if their goal was to get rate base, that it went into the more traditional -- traditional way of -- of -- of dealing with this -- with this case. But again -- and even that would not have made rate base because this was trying to create equity off of a loan. They would not have gotten equity off of that loan.

COMMISSIONER CLAYTON: Do you want a chance to respond, Mr. Mitten?

MR. MITTEN: Well, I'd just go back to

Mr. Trippensee, the -- the example that you use. You borrow $2 million from Central Bank and you invest it in plant-in-service. He's giving you $2 million worth of rate base. All we're asking is that the debt-based investment for Middle Fork be recognized in rate base. Plant's -- or Staff's proposal is to exclude 100 percent of that from rate base.

COMMISSIONER CLAYTON: Well, where -- where I was getting caught was that -- let's say -- let's say you make that assumption. You put the $2 million in rate base. The way this is structured, though, you already got it back. You already got that rate base back through -- through the way the rates were structured.

MR. MITTEN: We get the debt cost back.

COMMISSIONER CLAYTON: You get the cost and the principal, you get the principal and the -- and the -- the cost of funds.

MR. MITTEN: Yes, we do.

COMMISSIONER CLAYTON: Yeah. So -- so -- so that $2 million has been returned. So if I -- if I structure this in my mind that -- that you set this up rate base at $2 million, that $2 million has been returned, it's just not returned in the same way accumulated depreciation would return it. It's returned through this surcharge which means you get it all back.

MR. TRIPPENSEE: Commissioner, if I may? Mr. Mitten talks about borrowing the $2 million --

COMMISSIONER CLAYTON: Yeah.

MR. TRIPPENSEE: -- therefore, he has rate base. I'm not disagreeing that they have 2 million of original rate base.

COMMISSIONER CLAYTON: Yeah.

MR. TRIPPENSEE: Unfortunately for Mr. Mitten, accounting and -- and this Commission that uses generally accepted accounting principals is double-entry. For every debit there has to be a credit. And what he wishes you to ignore is either the debt or the repayment of that debt through this surcharge, and that is the offset which creates a zero rate base.

COMMISSIONER CLAYTON: Now, if -- if you don't have -- if you don't have an equity component in -- in the capitalization of the company, I mean, the return on equity component in theory is gonna be your -- your -- a profit amount.

The cost of the debt is going to the bank, that doesn't go -- doesn't go to Middle Fork, so that -- that's not making you any money. And because you don't have any equity, you're not making any profit either. Basically, you're just drawing the expenses off -- off this. So what -- I'm -- I'm trying make this fit into a traditional sense. So where do you make money on a deal like this?

MR. MITTEN: Well, you don't, that's just it. The way it's been treated, you don't make money.

COMMISSIONER CLAYTON: Well, let's -- well, then make it a not-for-profit --

MS. BAKER: They're also not being asked to invest either.

COMMISSIONER CLAYTON: You know, I mean, if it's a not-for-profit --

MR. MITTEN: It's not a not-for-profit, and that's one of the reasons --

COMMISSIONER CLAYTON: Has it ever made a -- has it ever made a profit?

MR. MITTEN: It's not made much of a profit, if any. And that's why we're in here, Commissioner Clayton, because there are some decisions the company has to make about whether or not it's viable to expand beyond its current service area --

COMMISSIONER CLAYTON: Yeah.

MR. MITTEN: -- to meet the needs for water in northwest Missouri.

COMMISSIONER CLAYTON: Yeah.

MR. MITTEN: Or how it's gonna finance the system upgrades that it has to make within its service territory. And right now, traditional debt finance investment makes no sense for this company because it's being asked to take on a risk for which it gets no return.

MS. BAKER: They're also asking the customers to pay again for something that they have already paid.

COMMISSIONER CLAYTON: I mean, I don't know if I disagree with either of those statements, I just don't know how to address it. From -- from Public Counsel's standpoint, I mean, the answer is that they've just got to invest equity into the -- into the -- the company to make it work and --

MS. BAKER: I mean, they are a company, they are there to -- to invest in it, to come to the Commission and get their -- their equity back and get their return on what they've invested. That -- that is -- that is how it -- how it is done.

MR. MITTEN: I think also in discussions with the Public Counsel, the one point he wanted to make sure was made is that the EIERA program is critical to the ability of all small companies in this state to invest because -- or to invest -- to put plant in the ground to serve the customers for both water and sewer.

The investment -- the cost of this type of plant is very high and usually a very small customer basis. To -- to have a high level of equity in these companies is probably very unreasonable for most small owners, and that's why the EIERA program is critical to allow them to do that.

Does that mean they don't have an equity investment and don't make a large profit -- or a large return of their money -- on their money, rather? That's true, but you can't ask the ratepayers to make the equity investment. That is unreasonable, as the courts have held. The EIERA program is the critical component to get monies so that these companies can do plant-in-service.

COMMISSIONER CLAYTON: Well, I -- this is the first case that I recall -- in my short time here, this is the first case that has been structured in this manner. It is not the first case where we've come up where we've had a dispute or a problem over rate base. I mean, how many water cases have we had where we're having difficulty establishing what an appropriate rate is because there is no rate base?

Or what is -- what should the sale price of a company be and whether there's an acquisition adjustment because the rate base is zero, book value is zero? We've got to find a way of fixing this, so I don't know. You guys are killing me here. Does anyone want to say anything else? I don't -- I don't think I have any other questions. I -- I --

MR. KRUEGER: I'd like to make -- I'd like to make a couple other points.

COMMISSIONER CLAYTON: Yeah.

MR. KRUEGER: We talked about the fact that the bonds -- the term of the bonds is for 20 years and that they're paid off in 20 years and the depreciation would take about 30 to 35 years. And the consequence of that is, if you pay off all the bonds in 20 years, you have gotten a complete return of and return on all investment within 20 years' period of time.

Then if you go back and say, okay, now we've still got a depreciated rate base out there and that should be included in rates, then you're going back to recover that again a second time. It's -- I don't -- I don't have a Sharpie here, so I don't know if you can see this or not.

But if this is year zero and you start -- and start here with the value of the plant, in 20 years you're gonna go down to zero by paying off the debt service, it depreciates down to zero over a longer period of time. And what the company is seeking to do is go a ways down here on this one and then jump up to this one and then go -- and then follow that out to -- to the end of the 35 years.

The other thing I would say is that this just is -- is not a traditional kind of ratemaking and so it can't necessarily be compared with Ameren and Laclede and KCPL in that there's the usage charge and then there's a separate surcharge.

COMMISSIONER CLAYTON: Did either Grant City or Stanberry intervene in this case?

MR. MITTEN: No.

MR. KRUEGER: No.

COMMISSIONER CLAYTON: Have the city governments chimed in to Public Counsel or Staff, concerns, issues?

MS. BAKER: I have not heard from them.

MR. KRUEGER: I have not heard from them.

COMMISSIONER CLAYTON: Are you -- you

haven't tried to reach out to them to find out, like to verify that letter that you're talking about, what their anticipation is, what do they expect?

MR. KRUEGER: Well, that letter -- the letter that I read from, Commissioner?

COMMISSIONER CLAYTON: Yeah.

MR. KRUEGER: Well, that was from 1992.

COMMISSIONER CLAYTON: Yeah, I'm aware, I know.

MR. KRUEGER: All right. Okay. No, I did not.

MR. MITTEN: There's no rate effect to what the company is seeking in this case which may have been why you didn't hear from the customers.

COMMISSIONER CLAYTON: Okay. Yeah, I remember the way it was set up.

I mean, the other issue, the other problem with these companies is that, you know, if this surcharge goes away -- I mean, when the debt runs out, then -- then that amount of revenue is gonna be gone and you're down to just the user -- the usage charge. But then it is gonna take extra investment that if you have to make repairs, a new plant, a new lagoon -- I mean ...

MS. BAKER: I mean, that -- that is

normal whenever a plant is depreciated out and it's --

COMMISSIONER CLAYTON: Nothing about these small companies is ever normal -- normal.

MS. BAKER: No, I understand.

COMMISSIONER CLAYTON: Nothing about them is ever normal, and --

MS. BAKER: I mean, it is expected that when the plant is depreciated out that new investment will be made. And whether it's actual capital from the company or if it's a loan --

COMMISSIONER CLAYTON: Well -- and this is what happens. What happens is that we get these companies that come in, they walk away or they abandon the plant or -- or they don't want to deal with it or -- you know? I mean, it happens time and again and we say, well, it's your obligation to go out and borrow the money, put yourself on the hook and go finance this plant. And they put their hands up and say, we had one guy just up and die and what -- willed it to his sister or something and ...

I mean, it -- I understand. It's easy to -- it's easy to say it's -- it's your obligation and then it falls on us, we deal with receiverships, everything else. There's just -- we've got to think creatively to find better ways of dealing with this, that it's fair.

If the ratepayers are gonna make contributions, I agree, they -- they have paid into this and -- and they need to be protected and made whole for their investment, they shouldn't have to be charged twice. On the other hand, what happens if the treatment plant goes under with this thing, you know? I mean, there's no rate base. I mean, I -- I don't know. It just -- it concerns me. Why don't you-all go work it out? That's what I suggest. And I don't have any other questions. Thanks.

JUDGE LANE: Thank you very much for participating, and I think we can go off the record and we're adjourned.

(WHEREUPON, the recorded portion of the oral argument was concluded.)

CERTIFICATE OF REPORTER

STATE OF MISSOURI)
)ss.
COUNTY OF COLE)

I, PAMELA FICK, RMR, RPR, CSR, CCR #447, within and for the State of Missouri, do hereby certify that the witness whose testimony appears in the foregoing deposition was duly sworn by me; that the testimony of said witness was taken by me to the best of my ability and thereafter reduced to typewriting under my direction; that I am neither counsel for, related to, nor employed by any of the parties to the action to which this deposition was taken, and further that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of the action.

____

PAMELA FICK, RMR, RPR, CSR, CCR #447