

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

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

THE OFFICE OF THE PUBLIC COUNSEL'S APPLICATION FOR REHEARING

COMES NOW the Office of the Public Counsel and for its Application for Rehearing states that rehearing is warranted and the Report and Order should be reheard because the decision is unlawful, unjust, and unreasonable and is arbitrary, capricious, unsupported by substantial and competent evidence, and is against the weight of the evidence considering the whole record, is unauthorized by law, and constitutes an abuse of discretion, all as more specifically and particularly described in this motion and as follows:

Application for Rehearing

A. Introduction

The Office of the Public Counsel (Public Counsel), pursuant to Section 386.500, RSMo.¹ and 4 CSR 240-2.160, specifically sets forth the reasons warranting a rehearing and moves the Missouri Public Service Commission (Commission) for rehearing of its Report and Order of April 30, 2014, effective May 30, 2014.

B. Failure to Apply Availability Fees Against Rate Base is Unlawful, Unjust and Unreasonable

The Report and Order is unlawful, unjust and unreasonable because the Commission's decision not to apply availability fees against rate base is unjust and unreasonable, unsupported

¹ All statutory citations are to the Revised Statutes of Missouri 2000, unless otherwise noted.

by substantial and competent evidence, is against the weight of the evidence considering the whole record, is unauthorized by law, and constitutes an abuse of discretion.

In the Report and Order, the Commission concluded that availability fees collected from owners of undeveloped lots in Lake Region's service territory should not be applied against rate base.² To justify this conclusion, the Report and Order states: "As the parties asserting that availability fees should be included in the determination of Lake Region's rates, Staff and Public Counsel bear the burden of producing evidence to support those allegations."³ However, the Commission mis-applies the burden of proof in this case. Staff and Public Counsel had no burden to prove that availability fees should be included in the determination of Lake Region's rates.

Sections 393.130 and 393.140, RSMo, requires the Commission to ensure that all rates set by the Commission are just and reasonable. Section 393.150.2, RSMo, makes it clear that at any hearing involving a requested rate increase the burden of proof to show the proposed increase is just and reasonable rests on the party seeking the rate increase. Lake Region had the sole burden to prove that plant it wished to include in rates had not already been recovered through other means, including through availability fees. The evidence shows Lake Region failed to meet that burden.

In the Report and Order, the Commission states:

Public Counsel estimated that the availability fees collected far exceed the amount of the contributions already donated as CIAC by the developer for system construction and argues that these excess fees should also be treated as CIAC and further reduce Lake Region's rate base. However, the Commission finds Lake

² Report & Order, pg. 44.

³ Report & Order, pg. 41.

Region's evidence that it would take 45 years for the availability fees to fully reimburse the developer for the donated infrastructure to be more credible than Public Counsel's estimates. This indicates that the lot owners have not yet paid any excess fees that would justify reducing Lake Region's rate base.⁴

In the Report and Order, the Commission merely states "Lake Region witness Larry R. Summers testified credibly that by his calculations it would take more than 45 years to recoup the developer's investment of \$5.3 million through the use of availability fees."⁵ The Commission makes no further statement that both Public Counsel and Staff presented evidence that was contrary to Lake Region's far-fetched assertion.

Lake Region agreed that the annual availability fees of \$300 for each undeveloped lot was specifically for both water and sewer availability from Lake Region.⁶ But, according to Lake Region, it would take 45 years to collect \$5.3 million through those availability fees. In sharp contrast, Public Counsel's analysis shows that during the calendar years of 1995 through 2013, approximately \$6.6 million of availability fees has been billed and/or collected by the utility and/or its owners.⁷ Therefore, the Commission had before it evidence that within a mere 18 years, the developers costs were already recouped. Even though it held the burden of proof, Lake Region did not provide any evidence to refute Public Counsel's calculations or methodology although it was given ample opportunity.

Similarly, the evidence produced by Staff also refutes Lake Region's claim. Staff estimates that the current annual amount of availability fee revenues is \$93,136 for Shawnee

⁴ Report & Order, pg. 43.

⁵ Report & Order, pg. 26.

⁶ Joint Stipulation of Undisputed Facts.

⁷ OPC Exhibit #4.

Bend Water and \$139,704 for Shawnee Bend Sewer.⁸ Using Staff's total of \$232,840 per year, the amount of time to collect \$5.3 million would only be 22 years – the year 2017. However, Staff's current annual total in this case is not reflective of the fact that between 1995 and today there were many more undeveloped lots than in Staff's current calculation. Therefore, the annual amount of availability fees between 1995 and today would have greatly exceeded Staff's total in this case of \$232,840 per year and significantly reduced the number of years to recover the \$5.3 million in developer investment. As a result, the evidence provided by Staff supports a finding that the developer's costs have already been recovered. Once again, even though it held the burden of proof, Lake Region did not provide any evidence to refute Staff's calculations or methodology although it was given ample opportunity.

Lake Region had the sole burden to prove that plant it wished to include in rates had not already been recovered through other means, including through availability fees. Even though Staff and Public Counsel had differing positions, both of their calculations regarding the availability fees support a finding that the original development costs have already been recouped through the availability fees. Lake Region is the only outlier. Lake Region provides no evidence to refute Staff and Public Counsel's calculations and provides no evidence to support its outlandish claim that it will take 45 years to recoup the developer's costs. As a result Lake Region did not meet its burden and the Commission decision that availability fees collected from owners of undeveloped lots in Lake Region's service territory should not be applied against rate base is not just and reasonable.

The Commission erred by determining that Public Counsel had the burden to prove that availability fees should be included in the determination of Lake Region's rates. Lake Region alone had the burden to prove that plant it wished to include in rates had not already been

⁸ Staff Exhibit #8.

recovered through other means, including through availability fees. The evidence shows Lake Region failed to meet that burden. As a result, the Commission decision that availability fees collected from owners of undeveloped lots in Lake Region's service territory should not be applied against rate base is not just and reasonable. Therefore the Report and Order is unlawful, unjust and unreasonable.

C. Inclusion of a Return on Equity of 11.93% is Unlawful, Unjust and Unreasonable

The Commission Report and Order is unlawful, unjust and unreasonable because the Commission's decision to approve a return of equity of 11.93% is unjust and unreasonable, unsupported by substantial and competent evidence, is against the weight of the evidence considering the whole record, is unauthorized by law, and constitutes an abuse of discretion.

In the Report and Order, the Commission states that Public Counsel's argument to maintain the current 8.50% as approved by the Commission is Lake Region's last rate case is not persuasive because Public Counsel did not provide sufficient financial analysis to demonstrate that 8.50% is consistent with current market costs or would support Lake Region's financial integrity and access to capital markets.⁹ However, the Commission again mis-applies the burden of proof in this case. Public Counsel had no burden to provide sufficient financial analysis proof – that burden was solely on Lake Region.

It is Lake Region who wishes to change the approved return on equity, not Public Counsel. Sections 393.130 and 393.140, RSMo, requires the Commission to ensure that all rates set by the Commission are just and reasonable. Section 393.150.2, RSMo, makes it clear that at any hearing involving a requested rate increase the burden of proof to show the proposed increase is just and reasonable rests on the party seeking the rate increase. Therefore, it is Lake

⁹ Report & Order, pg. 50.

Region's burden to prove that any increase in return on equity above what is included in current rates is just and reasonable.

Lake Region's existing rates were calculated based on a return on equity of 8.50%.¹⁰ As these rates were approved by the Commission, they are presumed just and reasonable. The evidence also shows that the 8.50% return on equity approved by the Commission in Lake Region's last rate cases was agreed to be just and reasonable by all parties. In Lake Region's last rate cases, SR-2010-0110 and WR-2010-0111, Staff witness Ms. Atkinson recommended that the Commission authorize a return on common equity of 8.00% to 9.00% as applied to Lake Region's September 30, 2009, actual capital structure of 16.36% equity and 83.64% debt.¹¹ In those cases all the parties, including Lake Region, agreed that the 8.50% mid-point of Staff's recommended return on equity range of 8.00% to 9.00% was a reasonable return on equity.¹² In this case, it was Lake Region's burden to prove that its desired increase from the current approved return on equity is just and reasonable. To do that, it was Lake Region's burden to prove that 8.50% was not consistent with current market costs and does not support Lake Region's financial integrity and access to capital markets. The evidence shows that Lake Region did not meet that burden.

The accepted premise is that the lower the amount of debt in the utility's capital structure, the lower the risk and therefore the lower the reasonable return on equity. On the flip side, the higher the amount of debt in the utility's capital structure, the higher the risk and therefore the higher the reasonable return on equity. The evidence indicated that Lake Region agreed with Staff and Public Counsel that an 8.50% return on equity was a sufficient reflection of the risk Lake Region faced in 2009. The evidence also showed that in 2009, Lake Region's

¹⁰ OPC Exhibit #4.

¹¹ *Id.*.

¹² *Id.*

actual capital structure was calculated by Staff to be 16.36% equity and 83.64% debt.¹³ In this case, the Commission concluded that the capital structure for Lake Region should be based on its actual capital structure of 40% equity and 60% debt.¹⁴ So, between 2010 and today, Lake Region's equity has increased from just over 16% to 40% while its debt decreased from nearly 84% to 60%. Therefore, the evidence shows quite clearly that Lake Region's current risk is similar if not lower than it was in 2010. It is not just and reasonable for the Commission to determine on the one hand that the amount of debt has decreased and thereby affirm that the amount of risk has also decreased but on the other hand approve a higher return on equity.

Additionally, the effect of the Report and Order is that the Commission has greatly increased the return on equity for Lake Region at a time when capital markets haven't increased – they have actually declined. Lake Region itself agreed to the 8.50% return on equity in the previous rate case so Lake Region must have been comfortable that its market cost of equity at that time would be sufficiently included. If 8.50% had been detrimental to Lake Region, logically Lake Region would not have agreed to that percentage. While Lake Region may be categorized as a small utility, it has had no problems obtaining financing under its own name as evidenced by the recent financing case, Case No. WF-2013-0118. Nor is Lake Region operating under any undue financial or operational stress.¹⁵ For its size, it is a fairly strong well-run utility and any risks it may be encountering do not appear to be insurmountable. Also the evidence showed that much of the risk that Lake Region faces is purely shareholder inflicted, not market driven.¹⁶

The only debt in Lake Region's name was an Alterra Bank loan of \$1,396,731 with an interest rate of 5%.¹⁷ Therefore, for Lake Region, the capital market is 5% and a return on equity

¹³ OPC Exhibit #4.

¹⁴ Report & Order, pg. 48.

¹⁵ Tr. Pg. 163.

¹⁶ OPC Exhibit #4.

¹⁷ *Id.*

of 8.50% more than generously reflects the market available to Lake Region. Just because higher numbers have been dangled in front of Lake Region by Staff, does not make 8.50% unreasonable. It just means that 8.50% is not as high as what Lake Region and its shareholders would like. But, 8.50% return on equity was reasonable in the last case and has been proven to be reasonable today to support Lake Region's financial integrity and access to capital markets.

The Commission erred when it determined that Public Counsel did not provide sufficient financial analysis to demonstrate that a return on equity of 8.50% is consistent with current market costs or would support Lake Region's financial integrity and access to capital markets, therefore 11.93% was reasonable. Public Counsel had no burden to provide sufficient financial analysis proof – that burden was solely on Lake Region. But, the evidence showed that Lake Region did not meet its burden. As a result, the Report & Order increasing Lake Region's return on equity to 11.93% is against the weight of the evidence and is unlawful, unjust and unreasonable.

D. Inclusion of Breach of Contract Legal Fees in Rates is Unlawful, Unjust and Unreasonable

The Commission Report and Order is unlawful, unjust and unreasonable because the Commission's decision to include in rates legal fees incurred by Lake Region in defending the circuit court breach of contract case and participating in the appeal is unjust and unreasonable, unsupported by substantial and competent evidence, is against the weight of the evidence considering the whole record, is unauthorized by law, and constitutes an abuse of discretion.

Sections 393.130 and 393.140, RSMo, requires the Commission to ensure that all rates set by the Commission are just and reasonable. Section 393.150.2, RSMo, makes it clear that at any hearing involving a requested rate increase the burden of proof to show the proposed

increase is just and reasonable rests on the party seeking the rate increase. The evidence showed that Lake Region did not meet that burden in regard to the legal fees at issue in the hearing.

Lake Region was sued by the developer for breach of contract. The Court records show, and Lake Region admits, that an Appeals Court judgment was entered on July 10, 2013, in favor of the developer not Lake Region.¹⁸ Court records also show the Missouri Supreme Court upheld the judgment of the Appeals Court in favor of the developer when it subsequently denied Lake Region's Application for Transfer.¹⁹ Through the judgment in favor of the developer, the Appeals Court found, and the Missouri Supreme Court apparently agreed, that Lake Region unreasonably and unlawfully breached its contract with Shawnee Bend Development.

Despite the loss of the case and a court determination that Lake Region unreasonably and unlawfully breached its contract, the Commission concluded that the legal fees incurred by Lake Region in defending the circuit court breach of contract case and participating in the appeal were reasonable and should be included in the calculation of rates for Lake Region.²⁰ In the Report and Order, the Commission states:

In rate cases, there is initially a presumption that a utility's expenditures incurred in providing utility service, which are one component of its revenue requirement, are prudent. This presumption can be rebutted upon a showing of serious doubt as to the prudence of the expenditure, at which point the utility must dispel this doubt and prove the questioned expenditure is prudent.²¹

By this, the Commission seems to indicate that a showing of serious doubt as to prudence is the only way to prevent costs from being passed on to the customers through their rates. However, the Missouri Statutes state that the Commission is authorized to approve costs for inclusion in

¹⁸ Tr. Pg. 344; *See* SD32077, *Shawnee Bend Dev. Co., LLC v. Lake Region Water & Sewer Co.*, 2013 Mo. App. LEXIS 353 (Mo. Ct. App. Mar. 25, 2013).

¹⁹ *See* SC93344, *Shawnee Bend Dev. Co., LLC v. Lake Region Water & Sewer Co.*, 2013 Mo. LEXIS 68 (Mo. June 25, 2013).

²⁰ Report & Order, pg. 52-53.

²¹ Report & Order, pg. 51-52.

rates only as long as the costs are just and reasonable. § 393.150, RSMo, as well as 393.130 and 393.140, RSMo. Therefore, the burden of proof is not merely that an expenditure was prudent, but that the costs related to that expenditure are just and reasonable to be included in rates.

Acting “prudently” does not automatically transform costs into reasonable costs for customers to bear in rates. Just and reasonable rates require that there be some benefit to the customer in exchange for the rates that they pay. For example a utility may “prudently” install larger plant than necessary to serve its current customers because it is cheaper and easier to do so while construction is going on, with the hopes that the plant will be used and useful for inclusion in rates in the near future. However, the costs for that additional plant are not just and reasonable to be put into rates until additional customers are added who then gain the benefit of that additional plant. It is not only the act of spending the money prudently that makes the costs just and reasonable to be included in rates. It is also the existence of a benefit to the customer. However, the evidence shows that no such benefit to the customer exists for the legal fees sought to be included in rates by Lake Region. Therefore, Lake Region did not meet its burden.

The Commission erred by determining that a showing of serious doubt as to prudence is the only way to prevent costs from being passed on to the customers through their rates. The evidence shows that these legal costs are not just and reasonable costs in the provision of utility service to the customer. Acting “prudently” does not automatically transform costs into reasonable costs for customers to bear in rates. Just and reasonable rates require that there be some benefit to the customer in exchange for the rates that they pay. Lake Region lost the legal case and as a result there was no benefit to the customers from these legal costs. As a result, the Report & Order allowing these costs to be put into customer rates is against the weight of the evidence and is unlawful, unjust and unreasonable.

E. Conclusion

Public Counsel's Application for Rehearing should be granted due to the fact that the Report and Order is unlawful, unjust, and unreasonable and is arbitrary, capricious, unsupported by substantial and competent evidence, and is against the weight of the evidence considering the whole record, is unauthorized by law, and constitutes an abuse of discretion.

WHEREFORE, Public Counsel respectfully requests that the Commission grant rehearing of its April 30, 2014 Report and Order.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

/s/ Christina L. Baker

By: _____
Christina L. Baker (#58303)
Deputy Public Counsel
P O Box 2230
Jefferson City, MO 65102
(573) 751-5565
(573) 751-5562 FAX
christina.baker@ded.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 28th day of May 2014:

General Counsel Office
Missouri Public Service Commission
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102
staffcounselservice@psc.mo.gov

Kevin Thompson
General Counsel Office
Missouri Public Service Commission
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102
Kevin.Thompson@psc.mo.gov

Lake Region Water and Sewer Co.
Mark Comley
P.O. Box 537
601 Monroe Street, Suite 301
Jefferson City, MO 65102-0537
comleym@ncrpc.com

/s/ Christina L. Baker
