

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

In the Matter of the Water Rate)
Increase Request of)
Hillcrest Utility Operating)
Company, Inc.)
)
Consolidated with,)
)
In the Matter of the Sewer Rate)
Increase Request of)
Hillcrest Utility Operating)
Company, Inc.)

Case No. WR-2016-0064

STAFF’S REPLY BRIEF

COMES NOW the Staff of the Missouri Public Service Commission (Staff), by and through counsel, and for its *Reply Brief* in the above-referenced matters, hereby responds to the arguments made by the other parties in their initial briefs.

INTRODUCTION

Staff upholds its positions as stated in its *Initial Brief*.

ARGUMENT

The Commission on its own webpage¹ states that it “must balance the interests of the public – ratepayers as well as company shareholders.” A balancing of interests means just that, a median between conflicting party positions. The Office of the Public Counsel (OPC) in its *Initial Brief*, quotes from case law² that, “the protection given the utility is merely incidental” in cases before the Missouri Public Service Commission.

¹ *A Snapshot of What We Do: A Publication of the Missouri Public Service Commission*, July 2015 <http://psc.mo.gov/CMSInternetData/ConsumerInformation/A%20Snapshot%20of%20What%20Do.pdf>.

² *State ex rel. Crown Coach Co. v. Public Service Commission*, 179 S.W.2d 123, 126 (Mo. App. 1944) “[t]he dominant thought and purpose of the [public utility law] policy is the protection of the public while the protection given the utility is merely incidental.”

Staff does not agree with this viewpoint due to its direct contradiction with the Commission's stated intent.

RATE OF RETURN

Staff recommends the Commission focus on the rate of return as the most critical element when balancing the interests of the parties. As stated in Staff's *Initial Brief*,³ "...the Commission is not bound to accept whatever cost of debt is "negotiated" and presented to it."⁴ Staff has no intention of cutting Hillcrest off at the knees, but rather seeks to protect the Hillcrest customers from a high interest rate that is not consistent with current, applicable junk bond yields. In addition, even though the investors and investment structure changed, this high interest rate was not reduced to reflect the new circumstances. However, as outlined in Staff's *Initial Brief*,⁵ in this case the debt investors have no incentive to renegotiate the interest rate on the financing agreement as they have provided all of the equity and debt capital invested in Hillcrest, which reduces any such transaction to less than arms-length.

Despite any allegations against Staff's numbers, the Company will still continue to have sufficient capital to function and no "theoretical niceties" factored into the calculations of Staff's debt cost. Staff affirms that its calculations relied on actual junk bond rates from widely recognized and easily verifiable sources.⁶ Throughout this case the Company has provided no support or testimony from investors or investing experts

³ Staff's Initial Brief P. 15.

⁴ *State ex rel, U.S. Water/Lexington v. Missouri Public Service Com'n*, 795 S.W.2d 593, 597 (Mo. App. 1990).

⁵ Staff's Initial Brief P. 14.

⁶ *Griffin Direct* Schedule SG-d2.

as to what an investor generally seeks in a company to instill confidence, yet it continually asks the Commission to recognize this interest. In fact, the Company provided no other testimony or witnesses than Josiah Cox. The Commission is left to speculate about investment rationales through a second-hand accounting via the testimony of Mr. Cox, even though the investors in this case, Robert P. and David Glarner, are tangible and real. Staff asks the Commission to consider not only the confidence of the investors, but also the confidence the ratepayers have in the utility. The only way to provide confidence to the ratepayers is for a utility to provide good service, which Staff's investigation revealed that Hillcrest accomplishes, and to charge reasonable rates developed from rate of return calculations that are the product of proper, arms-length transactions.

CORPORATE ALLOCATION FACTOR

Generally, an allocation factor is calculated based on the time devoted specifically to a utility, in this case Hillcrest, by a greater managing or parent company, in this case First Round, CSWR, LLC. Staff calculated its recommended allocation factor of 14% using current customer numbers compared to the anticipated size of First Round CSWR, LLC, once its anticipated acquisitions have been finalized.⁷ First Round CSWR, LLC, already oversees Indian Hills and Raccoon Creek along with Hillcrest, and has three more small utilities in various states of acquisition.⁸ Applying the known and measurable standard to this calculation, Staff determined the utilities First Round has acquired/is acquiring are most certainly known and it is possible to measure with a high

⁷ *Harrison Direct* P. 7, lines 9-11.

⁸ Tr. 2:112-113.

degree of accuracy the customer numbers of those utilities.⁹ OPC challenges Staff by citing to its witnesses Paul Harrison and Ashley Sarver in stating that Staff failed to provide evidence or justification, yet OPC's citations directly point to Staff's work product.¹⁰ Staff finds ample justification and evidence of its 14% allocation factor and prays the Commission will agree.

PAYROLL

Staff upon calculating payroll looked at the current structure of Hillcrest and what the structure will be once the acquisition process for some of the other small utilities is finalized.¹¹ Because Hillcrest is already part of a greater utility system due to the setup of Central States Water Resources, Inc., as the manager of First Round CSWR, LLC, Hillcrest is now comparable to a portion of a larger utility system rather than a small water and sewer system.¹² Due to that setup, it is not proper to compare Hillcrest to standalone water and sewer facilities and for that reason OPC is incorrect when it recommends hourly rates and job titles based on those comparisons.

As to the proper number of work hours to include in payroll calculations, the final dollar amount and the Company's opinion of whether that is a large or small amount should not be the factor in determining the proper accountable hours to include in rate base. Staff determined an appropriate calculation for work hours based on investigation

⁹ *In the Matter of Kansas City Power & Light Companys Request for Auth. to Implement A Gen. Rate Increase for Elec. Serv.*, ER-2014-0370, 2015 WL 5244724, at *71 (Mo. P.S.C. Sept. 2, 2015), *reh'g denied*, ER-2014-0370 ET AL, 2015 WL 6577447 (Mo. P.S.C. Oct. 22, 2015). Both the Office of Public Counsel and Staff relied on this definition during the hearing.

¹⁰ OPC Initial Brief P. 3-4.

¹¹ Tr. 2:191.

¹² *Id.*

of the employee's duties to Hillcrest using Josiah Cox's timesheets, and included these details in its *Initial Brief*.¹³

The fact that the First Round employees have respectable résumés has not been an issue in this matter. The fact that the employees have less than a year's experience applicable to this proceeding working for a regulated utility, specifically Hillcrest, is at issue in this matter.¹⁴ Company witness Josiah Cox candidly agreed at the evidentiary hearing that the NARUC uniform system of accounts and regulated utility tariffs require specialized understanding.¹⁵ The Missouri Economic Research and Information Center (MERIC) established three distinct levels to categorize employees for the purpose of determining salary. Staff used the middle level to recognize that Hillcrest employees have a skillset applicable to some of their assigned tasks, but when it comes to the regulated utility world, are still very new.

The ratemaking process necessarily requires utilities to spend money up front and then collect a reimbursement through rates for those amounts. In this case, the test year begins April 1, 2015, and the update period does not end until October 31, 2015.¹⁶ Contrary to allegations that the data is two years old, Staff actually used salary data updated through December 2014, resulting in data that is not even one year old as of the end of the determination period in this matter. Factoring in that 2016 is only half-done, the data will still not be two years old by the date of the Commission's report and order.

¹³ Staff's Initial Brief P. 20.

¹⁴ Tr. 2:96.

¹⁵ Tr. 2:95, line 18 to 96, line 2.

¹⁶ *Harrison Direct* P. 3, lines 13-14.

RATE DESIGN

In creating its recommended rate design alternatives, Staff focused its concerns on Hillcrest receiving a fair return and the customers paying an amount that was manageable despite the sharp increase.¹⁷ Unlike OPC, Staff did not find it imperative to focus on the allocation of expenses between the customer charge and volumetric rate in testimony. The customer charge and volumetric rate are determined differently by each rate design analyst;¹⁸ it is an art, not a science. Additionally, as one half of the equation varies (i.e. the usage rate), the other half (i.e. the customer charge) naturally trends in the opposite direction; or as one increases, the other decreases.¹⁹ To that end, when OPC allocated its customer charge and volumetric rate differently than Staff's rate design analyst, OPC's customer charge, which is the fixed amount charged to every customer, became higher than that recommended by Staff.²⁰ As stated in the Report and Order for Missouri American Water Company (Case No. WR-2015-0301), utilities usually prefer to recover costs through customer charges because the costs and the charges are fixed rates and the risk that the company will not adequately recover its costs is reduced.²¹ However, as the order also states, consumers' groups and environmentalists generally prefer utilities to recover costs through volumetric rates because it allows customers more control of their total bill.²² OPC witness Russo agreed

¹⁷ *Robertson Direct* P. 6, lines 14-18.

¹⁸ Tr. 2:222, line 19 to 223, line 2 (Where OPC witness Russo was asked, "And do you agree that there's a variety of methods that a rate design analyst could use to develop rates?" and he answered in the affirmative).

¹⁹ Tr. 2:223, line 15 to 224, line 1.

²⁰ Tr. 2:224.

²¹ Report and Order, *In the Matter of Missouri-American Water Company's Request for Authority to Implement a General Rate Increase for Water and Sewer Service Provided in Missouri Areas*, Case No. WO-2015-0301, P. 36.

at the evidentiary hearing that a higher customer charge results in a lower commodity charge in rates.²³ When volumetric rates or commodity charges constitute a higher portion of the overall rate, the customers have less ability to lower their bills through adjusting their usage.

It is difficult to recognize the similarities between Staff and OPC's proposed rate designs due to OPC's witness using a different projected usage amount and applying different property tax amounts than Staff. Staff has created workpapers outlining the similarities when these factors are aligned should the Commission desire demonstrative evidence.

Staff took no position between its phase-in alternatives recommended in this matter. Staff did not want to provide a rate design that favored one party over another and thus gave the Commission the flexibility to determine the best manner to balance party interests. Staff specifically designed its phase-in rate to omit only non-cash items for the one-year period of phase-in so as not to damage the company's ability to continue operations.²⁴

AUDITING AND TAX PREPARATION FEES/PROPERTY TAX

Staff continues to recommend amounts of \$168 for each utility for auditing fees and tax preparation costs.²⁵ In referencing the differing positions of Hillcrest and Staff as to the appropriate property tax amount to include in rate base, the Company stated, "Hillcrest has worked with the Cape Girardeau County Assessor's office in an effort to

²² *Id.*

²³ Tr. 2:223-224.

²⁴ *Robertson Direct* P. 8, Lines 17-20.

²⁵ *Harrison Rebuttal* P. 6, lines 11-13.

make the taxes as affordable as the County Assessor will allow.”²⁶ This statement is confusing as it suggests that a party can negotiate its taxes with the assessor, and to Staff’s knowledge there is no such opportunity available to utilities. Staff has not seen any substantive evidence to sway from its recommended amount for property taxes of \$164 each for water and sewer, with additional amounts to be updated in the rate review or next rate case to be filed one year from the effective date of rates in this matter.

The Company suggests applying a surcharge or tracker to auditing, tax preparation, and property tax amounts. The Commission has found that trackers and surcharges tend to be appropriate when events are known and measurable, certain to occur, and the impact can be calculated with a high degree of accuracy.²⁷ Here the increases are certain to occur but the amounts are neither known and measurable nor able to be calculated with high accuracy as Staff argued in its *Initial Brief*.²⁸ Coupling that with the rate case or review to be filed in one year, which would remedy any differences in projected and actual amounts, Staff would recommend that a tracker or surcharge is inappropriate for this matter.

²⁶ HC Initial Brief P. 11.

²⁷ Report and Order, *In the Matter of the Application of Peaceful Valley Service Company’s Request for Increase in Sewer Operating Revenues; In the Matter of the Application of Peaceful Valley Service Company’s Request for Increase in Water Operating Revenues*, Case Nos. SR-2014-0153 and WR-2014-0154, P. 11.

²⁸ Staff’s Initial Brief P. 24-25.

CONCLUSION

In conclusion, Staff wishes to express that it has not changed its positions from those statements made in its *Initial Brief*. Based on the information in that document and the points Staff addresses here, it asks the Commission to use its recommendations in issuing determinations on the matters of the corporate allocation factor, payroll, rate design, income tax and auditing fees, property taxes and the rate of return.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic mail, or First Class United States Postal Mail, postage prepaid, on this 15th day of June, 2016, to all counsel of record.

/s/ Whitney Payne