



FILED²

AUG 15 2016

Missouri Public Service Commission

Missouri Public Service Commission (Date File Stamp)

Judge or Division:	Appellate Number:	10:03am MA
Appellant: The Office of the Public Counsel		Missouri Public Service Commission File Number: WR-2016-0064
Respondent: Missouri Public Service Commission		

Notice of Appeal

Notice is given that The Office of the Public Counsel appeals to the Missouri Court of Appeals Western Eastern Southern District.

August 15, 2016
Date Notice of Appeal
(to be filled in by Secretary of Commission)

Lera Shemwell
Filed Signature of Attorney or Appellant

The notice of appeal shall include the appellant's application for rehearing, a copy of the reconciliation required by subsection 4 of section 386.420, a concise statement of the issues being appealed, a full and complete list of the parties to the commission proceeding, and any other information specified by the rules of the court. The appellant(s) must file the original and (2) two copies and pay the docket fee required by court rule to the Secretary of the Commission within the time specified by law. Please make checks or money orders payable to the Missouri Court of Appeals. At the same time, Appellant must serve a copy of the Notice of Appeal on attorneys of record of all parties other than appellant(s), and on all parties not represented by an attorney.

CASE INFORMATION

Appellant Attorney / Bar Number: Lera Shemwell, MO Bar # 43792		Respondent's Attorney / Bar Number: Shelley Brueggemann, MO Bar #52173	
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Date of Commission Decision: Issued: 7/12/2016 Effective: 8/11/2016		Date of Application for Rehearing Filed: 7/21/2016	Date Application for Rehearing Ruled On: 8/10/2016

DIRECTIONS TO COMMISSION

A copy of the notice of appeal and the docket fee shall be mailed to the clerk of the appellate court. Unless otherwise ordered by the court of appeals, the commission shall, within thirty days of the filing of the notice of appeal, certify its record in the case to the court of appeals.

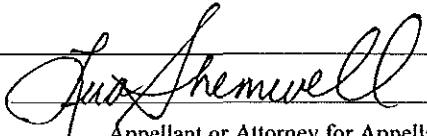
Certificate of Service

I certify that on 8-15-16, I served a copy of the notice of appeal on the following parties, at the following address(es), by the method of service indicated.

Dean L Cooper – US Mail
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Appellant or Attorney for Appellant

FORM 1. CIVIL CASE INFORMATION FORM SUPPLEMENT

**MISSOURI COURT OF APPEALS
WESTERN DISTRICT**

No. WD _____

Office of the Public Counsel,

Petitioner/Appellant

Lera Shemwell, Bar Number 43792
P.O. Box 2230
Jefferson City, MO 65102

vs.

Missouri Public Service Commission

Defendant/Respondent

Shelly Brueggemann, Bar Number 52173
P.O. Box 360
Jefferson City, MO 65102

Date Notice filed with the Public Service Commission 8-15-2016

The Record on Appeal will consist of a Legal File Only. (This will include records filed pursuant to Rules 81.13 and 81.16)

FACTUAL BACKGROUND: Hillcrest is a water corporation and a sewer corporation regulated by the Commission. On September 15, 2015, Hillcrest filed a letter at the Commission asking the Commission to increase its water and sewer rates. The cases are WR-2016-0064 and SR-2016-0065. The Commission used its procedure for small utilities. On March 25, 2016, Hillcrest and the Commission Staff filed a partial resolution of numerous issues. Among the issues left unresolved are the cost of debt, corporate allocations, payroll and rate design. The Commission issued its Report and Order on July 12, 2016.

ISSUES: The PSC's Report and Order is unlawful because the Commission improperly concluded a utility-claimed cost, which resulted from self-dealing, was prudently incurred and, in doing so, incorrectly shifted the burden of proof from the Company to Commission Staff in violation of Section 393.150.2 RSMo.

The Report and Order is not supported by competent and substantial evidence upon the whole record as the PSC's decision to grant Hillcrest's request to include a 14% cost of debt was against the weight of the evidence, in that that the owner is not a credible witness and Hillcrest did not present competent and substantial evidence to support the prudence of its proposed cost of debt expense.

STATEMENT OF THE ISSUES

(As required by § 386.510 RSMo)

Appellant Public Counsel will raise the following issues on appeal:

1. The Office of the Public Counsel (OPC) challenges the lawfulness and reasonableness of the Public Service Commission's (PSC) findings and conclusions issued in its July 12, 2016 Report and Order. Specifically, OPC raises the following issues:
 - The PSC's Report and Order is unlawful because the Commission improperly concluded a utility-claimed cost, which resulted from self-dealing, was prudently incurred and, in doing so, incorrectly shifted the burden of proof from the Company to Commission Staff in violation of Section 393.150.2 RSMo.
 - The Report and Order is not supported by competent and substantial evidence upon the whole record as the PSC's decision to grant Hillcrest's request to include a 14% cost of debt was against the weight of the evidence, in that that the owner is not a credible witness and Hillcrest did not present competent and substantial evidence to support the prudence of its proposed cost of debt expense.

LIST OF PARTIES TO THE COMMISSION PROCEEDING

(As required by § 386.510 RSMo)

The following parties participated in Public Service Commission Case Numbers GO-2015-0341 and WR-2016-0064:

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Public Service Commission

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

In the Matter of the Water Rate Request of)
Hillcrest Utility Operating Company, Inc.) File No. WR-2016-0064 et al.

APPLICATION FOR REHEARING

COMES NOW the Missouri Office of the Public Counsel (“OPC” or “Public Counsel”) pursuant to Section 386.500 RSMo (2015)¹ and 4 CSR 240-2.160(2) and for its Application for Rehearing of the Public Service Commission’s (“PSC” or “Commission”) July 12, 2016 Report and Order (“Order”). In support of its Application, Public Counsel states the rates imposed on Hillcrest’s captive customers are unjust, unreasonable, and an economic shock to a small community. The Commission’s Order is unlawful, and may inadvertently encourage self-dealing.

THE FACTS

The moment Mr. Cox admitted he was part owner of the company, the burden of proof that 14% was a reasonable cost of debt shifted immediately and permanently to him. *Office of Public Counsel v. Missouri Public Service Com’n*, 409 S.W.3d 370 (Mo. 2013).

At hearing, Staff explained the ownership structure and testified the cost of debt was not the result of good faith negotiations between unrelated entities. This testimony further glued the burden of proof on Mr. Cox. Staff’s concern was that “the debt and equity investors are the same people – the Glarners” (Tr. Vol. 2, 165:15–25) is based on the *company’s* own testimony.

At hearing, under Public Counsel’s questioning, Mr. Cox revealed the structure of First Round-Central States Water Resources. The Glarners are the “ultimate owners” and Mr. Cox has a 14-percent ownership interest. (Tr. Vol. 1, 50:17 – 51:12). Mr. Cox and his partners “negotiated” a

¹ All references to statute are to RSMo 2000 as currently supplemented, unless otherwise noted.

14% cost of debt. That the owners are the investors and are able to claim a 14% cost of debt is the definition of self dealing. By statute, Hillcrest has the burden of proof that the cost of debt is just and reasonable. Section 393.150.2 RSMo.

Mr. Cox further admitted that the transactions are complex.

At hearing, Public Counsel questioned Mr. Cox about the “[c]omplexity of the investment structure”, and inquired “is the way Hillcrest is set up and the way that money flows, is that a complex structure in your opinion?” Mr. Cox responded simply: “Yes.” Next, Public Counsel asked, “Is it overly complex?” Mr. Cox explained: “It is very hard to understand what has happened originally with the investment structure that was presented to staff in the certificate and financing case up to now.”

Moreover, in response to the question, “[a]nd is that because as you state in Line 13 that there is a lack of transparency and access to information?” Mr Cox agreed, saying “Yes.” (Tr. vol. 1, 164:23–25 165:1–14.)

The Commission found Mr. Cox credible concerning his efforts to secure market financing. Mr. Cox’s credibility was ruined by his misrepresentations to the Bankruptcy Court. Following his testimony, about his representations to the Bankruptcy Court, Mr. Cox cannot be considered an entirely credible witness. Public Counsel has attached that portion of the transcript for the Commission’s convenience. (*see* Attachment 1) In his bankruptcy schedules, Mr. Cox failed to include his six-figure salary, the fact he had signature authority on a bank account containing \$800,000, and that he was going to be President of Central States Water Resources. (*Id.*)

THE LAW

The 14% cost of debt results from self-dealing, which puts Hillcrest’s customers at risk. The *Atmos* Court spoke of the critical risk to a company’s customers when affiliate transactions are involved: “This greater risk [to utility customers] inherent in affiliate transactions arises because

agreements between a public utility and its affiliates are not “made at arm’s length or on an open market. They are between corporations, one of which is controlled by the other. As such they are subject to *suspicion and therefore present dangerous potentialities*.” The Court continued adding an additional warning: [o]ne concern is that where one affiliate in a transaction has captive customers, a one-sided deal between affiliates can saddle those customers with additional financial burdens.” *Id.* (emphasis added). That is the case here.

The Court further instructed that the Commission’s own Affiliate Transactions Rules were promulgated to deal with just such transactions: “For these reasons, the rationale for permitting a presumption of prudence in arms-length transactions simply has no application to affiliate transactions. The PSC enacted the affiliate transaction rules in 2000 with the *precise* purpose of thwarting unnecessary rate hikes due to cross-subsidization.” *Id.* (emphasis added). The Company has the burden of proof. The Commission incorrectly placed the burden of proof on its Staff.

The Commission erred in putting the burden of proof on its Staff.

The idea affiliate transactions could enjoy a presumption of prudence “argument is based on a misunderstanding of the concept of burden of proof.” *Id.* “Missouri law sets out the burden of proof in PSC proceedings. [T]hose statutes provide that [utilities] have the burden to prove that the . . . costs it proposes to pass along to customers are just and reasonable. Section 393.150.2.” *Id.* Crucially, Staff never has the burden of proof that costs are unjust or unreasonable. By statute, that burden always remains with the utility. This is especially important when self dealing is involved.

The reason the Company has the burden of proof and the burden of going forward with the evidence is that “affiliate transactions “correspond to the probability of collusion . . .” ‘a presumption of prudence is *inconsistent* with the rationale for the affiliate transaction rules *and with the PSC’s obligation to prevent regulated utilities from [overcharging customers]*.” *Id.* at 378 (emphasis added). “The reason for this distinction between affiliate and non-affiliate expenditures

appears to be that the probability of unwarranted expenditures corresponds to the probability of collusion.” *Id.*

Since affiliate transactions have no presumption of prudence, the Commission’s Staff has no responsibility to present any evidence at all. Specifically, absent any presumption of prudence, no other party, in this case Staff, needs to present any evidence to raise serious doubt about the prudence of the cost of debt. That doubt is inherent in affiliate transactions. The Company has the burden to prove prudence. The Commission erred in putting the burden of proof on its Staff.

The Commission’s failure to require Hillcrest to prove that the cost of debt is just and reasonable renders the Commission Order unlawful.

While the Commission has not promulgated an affiliate transactions rule for water companies, the statutory burden to prove the costs it “proposes to pass along to customers are just and reasonable” remains on the Company. Section 393.150.2 RSMo. The Commission’s affiliate transaction rules are instructive as to the nature of the evidence required. “The utility provides a financial advantage if it ‘compensates an affiliated entity for ... goods or services above the lesser of ... [t]he fair market price ... or [t]he fully distributed cost to the [utility] to provide ... goods or services for itself.” 4 CSR 240–40.016(3)(A).

In this regard, Hillcrest offered no evidence. If the Company fails to provide competent and substantial evidence, the Commission should disallow the cost and grant rehearing to reopen the record for evidence concerning the cost of debt.

Even though it has no burden of proof, Staff diligently performed its analysis pointing to the range of *.88% to 10.13% as a reasonable cost of debt. Staff based its recommendation on junk bond debt yields from published indices. Staff’s states this level of cost of debt “would satisfy a hypothetical third-party debt investor’s market requirements. (Order at pp. 11, *citing* Staff Ex. 4, Griffin Direct, p. 4-7; Staff Ex. 6, Griffin Rebuttal, p. 5.)

The Commission should protect consumers from the entire risk of the company's purported difficulty obtaining financing.

Cross-examination of Mr. Cox demonstrated that his bankruptcies are the most likely cause of his purported difficulties obtaining financing. In finding that 14% is the appropriate allowed debt rate to apply in this case, the Commission is shifting the entire risk of procurement of financing on to ratepayers. Mr. Cox and Fresh Start should share a portion of the risk. The Commission's purpose is to protect the consumer against the natural monopoly of the public utility. Hillcrest customers do not have the option to seek service from a more competitive supplier.

Mr. Cox reportedly sought financing from “over fifty specialized infrastructure institutional investors, private equity investors, investment bankers and commercial banks on behalf of Hillcrest and its parent company.” Hillcrest Ex. 1, Cox Direct, p. 24; Transcript, Vol. 2, p. 51. This lack of interest surely caused Mr. Cox some concern yet he still decided to purchase this distressed company.

The Commission should reconsider the corporate allocation factor.

In making its decision in this case, the Commission found Mr. Cox's testimony to be credible. This is the same Mr. Cox made significant misrepresentations to the Bankruptcy Court. To rely on his self-interested testimony here is not reasonable.

The Commission's decision may have undesirable public policy implications.

In its Order the Commission found “[t]he evidence shows that after diligent efforts to obtain financing from a variety of potential lenders, the only financing available to Hillcrest at that time was the transaction with Fresh Start. Penalizing Hillcrest now for that decision would be unfair and may discourage other companies from acquiring and improving troubled water and sewer utilities in the future, which would be contrary to good public policy. Rewarding Mr. Cox's lack of credibility and unusual business practices are also contrary to good public policy.

The *undesirable result* of the Commission's decision to allow a 14% cost of debt is more likely to encourage affiliate abuse and self-dealing to increase rates. That is much worse public policy.

CONCLUSION

The Commission's Order is not lawful, not supported by competent and substantial evidence on the whole record and is arbitrary, capricious and an abuse of discretion.

WHEREFORE, The Office of the Public Counsel respectfully recommends that the Commission grant its Application for Rehearing for the reasons set forth above and for such other and further relief the Commission deems necessary under the circumstances.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 21st day of July, 2016.

/s/ Lera L. Shemwell

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(Wherein, return to public session.)

JUDGE BUSHMANN: Back in public session.

BY MS. MAYFIELD:

Q. Now, Mr. Cox, what was your involvement with Central States Water Resources in January of 2014?

A. I believe in January '14 is when we started looking at forming the company.

Q. And the company formally formed at the end of January 2014. Correct?

A. I believe it was February, ma'am.

JUDGE BUSHMANN: Do you have copies for the bench?

MS. MAYFIELD: I think I'm just going to see

1 if this -- perhaps by looking at this document if this
2 helped to refresh Mr. Cox's recollection of the formation
3 date.

4 BY MS. MAYFIELD:

5 Q. By looking at this document, is your
6 recollection refreshed as to the formation date of central
7 States Water Resources, Incorporated?

8 A. Yes, ma'am. It was the end of January. I
9 see here on the document.

10 Q. So January the 27th of 2014; is that
11 correct?

12 A. That is correct, ma'am.

13 Q. And had you done any work to solicit capital
14 contributions from investors on or around that date?

15 A. Yes, ma'am.

16 Q. And that would've been the initial
17 contributions that would've come in totaling the amount of
18 \$864,000; is that correct?

19 A. Yes. Those contributions did not come in
20 until February.

21 Q. You have a copy of the general ledger, I
22 believe.

23 A. I do.

24 Q. If you would turn to Page 3 of that general
25 ledger, at the bottom, I understand that you previously

1 testified that this general ledger was prepared as part of
2 this rate case. At the bottom do you see that the initial
3 capital contributions came in on January the 26th of 2014?

4 A. I do, ma'am.

5 Q. All right.

6 A. Sorry. One month off.

7 Q. And as president of Central States Water
8 Resources you control and direct everything within Central
9 States Water Resources. Correct?

10 A. Yes, ma'am.

11 Q. Mr. Cox, what was your involvement with
12 First Round CSWR, LLC in January of 2014?

13 A. I didn't personally own any shares in First
14 Round CSWR, LLC.

15 Q. That's not the question I asked. I asked
16 you what was your involvement with First Round CSWR, LLC?

17 A. I was the president of First Round, LLC.

18 Q. And First Round CSWR, LLC, it was formed at
19 the end of January; is that correct?

20 A. Ma'am -- yes, ma'am. I believe that's true
21 based on the documents you're putting in front of me. So
22 yes.

23 Q. Based on the document that I've placed in
24 front of you, does this refresh your recollection as to the
25 formation date for First Round CSWR, LLC?

1 A. Yes, ma'am. It does.

2 Q. And is that January the 23rd of 2014?

3 A. Yes, ma'am. It is.

4 Q. And that was 15 days before your bankruptcy.

5 Correct?

6 A. Yes, ma'am. It is.

7 Q. So you would've been filling out your
8 bankruptcy schedules at the same time that you were forming
9 First Round and Central States Water Resources,
10 Incorporated. Correct?

11 A. Yes, ma'am. I shut my original company down
12 in the summer of 2013.

13 Q. On Page 6 -- if you would turn to Page 6 of
14 your bankruptcy schedules.

15 A. Yes, ma'am.

16 Q. This shows that you took a credit counseling
17 course on December 18th of 2013; isn't that correct?

18 A. Yes, ma'am.

19 Q. So you knew you were going to be filing a
20 bankruptcy as early as December 18th of 2013; isn't that
21 right?

22 A. Yes, ma'am.

23 Q. Did you advise your bankruptcy counsel that
24 you were working with First Round CSWR and with Central
25 States?

1 A. Yes, ma'am.

2 Q. You didn't list either one of those
3 companies on your schedules, did you?

4 A. No, ma'am. I didn't personally own them.

5 Q. Did you alert anyone that CSWR would be
6 paying you a six-figure salary during 2014?

7 A. I don't remember, ma'am.

8 Q. If you turn to Page 59 and 60 of your
9 bankruptcy petition, please, there's a question they're
10 asking you for information about your income. Correct?

11 A. Yes, ma'am.

12 Q. And if you take a look specifically at
13 Question 13 at the bottom of Page 60, it says, "Do you
14 expect an increase or decrease within the year after you
15 file this form?" And you marked no; is that correct?

16 A. Yes, ma'am. That's correct.

17 Q. Yet within 30 days after the filing of your
18 bankruptcy you started making a salary of \$16,197.26 per
19 month; is that correct?

20 A. Yes, ma'am.

21 Q. So you knew you had investors lined up to
22 make capital contributions for CSWR prior to your
23 bankruptcy, didn't you -- well, based on the capital
24 contributions in January?

25 A. Ma'am, I did not have everything lined up at

1 that point. It was still in flux. So I was trying very
2 hard to make everything work.

3 Q. But in January of 2016 -- January 26 of
4 2014, I believe you've indicated that you have acknowledged
5 that that is when the initial capital contributions came in
6 funding First Round CSWR. Correct?

7 A. Yes, ma'am. Our corporate documents were
8 not done yet, so we were still very much in the negotiation
9 phase.

10 Q. Now, Mr. Cox, when the CSWR bank account was
11 created -- or the CSWR bank account is created at
12 Enterprise Bank, MM; is that correct?

13 A. Yes, ma'am.

14 Q. Do you know when that CSWR bank account was
15 created at Enterprise Bank, MM?

16 A. No, ma'am. I don't remember the exact date.

17 Q. Would it have been sometime during January
18 of 2014?

19 A. That sounds correct.

20 Q. Do you know who has signature authority on
21 that account?

22 A. Myself.

23 Q. Did you have a debit card for the company?

24 A. I believe I did.

25 Q. Would you have gotten that at the same time

1 or about the same time you would've opened up the bank
2 account?

3 A. Possibly. I don't remember exactly.

4 Q. All right. And you do have the general
5 ledger in front of you. I would ask you to just turn to
6 that real quickly, back to Page 3.

7 A. Yes, ma'am.

8 Q. Can you see there that on January 26th of
9 2014 at the bottom that the bank account went up by over
10 \$800,000? Is that correct?

11 A. Yes, ma'am. I see that.

12 Q. And did you indicate on your bankruptcy
13 schedules that you were going to be a part of these
14 companies in the future?

15 A. No, ma'am.

16 Q. The meeting making you the president of
17 Central States Water Resources was held on February the
18 13th of 2014; wasn't that right?

19 A. I don't remember the exact date, ma'am.

20 Q. Would it have been February of 2014?

21 A. That sounds correct, ma'am.

22 Q. All right. I've handed you a document
23 titled Consent of the Board of Directors of Central States
24 Water Resources, Incorporated. After having taken a look
25 at this document, does this refresh your recollection of

1 the time you became the president of Central States Water
2 Resources?

3 A. Yes, ma'am. It does.

4 Q. And was that date February the 13th of 2014?

5 A. Yes, ma'am.

6 Q. Now, your first meeting of creditors for
7 your bankruptcy was held on March 4th of 2014, wasn't it?

8 A. That is correct, ma'am.

9 Q. Did you report to Mr. Radlof, the trustee in
10 your bankruptcy, that you had become the president of
11 Central States Water Resources at your 341 bankruptcy
12 meeting?

13 A. I do not recall that.

14 Q. Did you advise Mr. Radlof on March 4th, 2014
15 that your income was changing?

16 A. My attorney was in charge of all that.

17 Q. Sir, you did sign your bankruptcy petition
18 under oath. Correct?

19 A. Yes, ma'am.

20 Q. Your schedules do not contain any reference
21 to CSWR or Central States; isn't that correct?

22 A. Sure. I acknowledge that, ma'am.

23 Q. Both were formed and you knew as of the date
24 of filing that you would be affiliated with both of them;
25 isn't that correct?

1 A. Ma'am, I had a ton of legal counsel in this
2 whole thing, so I don't --

3 Q. I am asking you, you knew as of the date of
4 filing that you were affiliated with both of those
5 companies. Correct?

6 A. Yes, ma'am.

7 Q. And you never put those on your bankruptcy
8 schedules, did you?

9 A. Ma'am, I used counsel on that whole thing.

10 Q. You never put -- these entities do not show
11 up anywhere on your bankruptcy petition, do they?

12 A. No, ma'am.

13 Q. And these same schedules were the ones that
14 allowed you to discharge on June 6th of 2014 over \$2.3
15 million in debt; isn't that true?

16 A. Yeah. These petitions were responsible for
17 that. That is correct.

18 MS. MAYFIELD: Your Honor, I have no further
19 questions of this witness at this time.

20 JUDGE BUSHMANN: We've been going for a
21 while. Why don't we take a short break and recess until
22 eleven o'clock.

23 (Off the record.)

24 JUDGE BUSHMANN: Back on the record. Now,
25 we're ready for cross-examination by Staff. Mr. Cox,