

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



In the Matter of the Rate Increase Request of)
Indian Hills Utility Operating Company, Inc.)

File No. WR-2017-0259

REPORT AND ORDER

Issue Date: February 7, 2018

Effective Date: February 17, 2018

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The Commission is ordering Indian Hills Utility Operating Company, Inc. (“Indian Hills”) to file new tariffs¹ in compliance with this report and order (“compliance tariffs”) providing a rate base of \$663,596 and an overall rate of return at 9.375 percent as follows:

<i>Capital Structure</i>	<i>Cost of Debt</i>	<i>Return on Equity</i>
50% debt / 50% equity	6.75%	12%

That compares with Indian Hills’ request for revenue above current collections approximately as follows²

<i>Increase</i>	<i>Amount</i>
<i>Requested</i>	\$750,280
<i>Ordered</i>	\$663,596

The Commission separately states its findings of fact,³ reports its conclusions of law,⁴ and orders relief as follows.

¹ Tariff is the shorthand term used in Commission practice for the “schedules” described in Section 393.130.1, “showing all rates and charges made, established or enforced or to be charged or enforced, all forms of contract or agreement and all rules and regulations relating to rates, charges or service used or to be used, and all general privileges and facilities granted or allowed by such gas corporation, electrical corporation, water corporation, or sewer corporation [.]” Tariff may refer to an entire set, a subset, or a single page, of such schedules.

² These numbers do not constitute a ruling, only an estimate of the overall impact of this report and order based on the preliminary figures filed by the Commission’s staff in the Commission’s Electronic Filing Information System (“EFIS”) No. 179 (January 16, 2018) *Staff’s Rate Design Scenarios*. References to EFIS refer to this file No. WR-2017-0259 except where stated otherwise.

³ Where required by Section 536.090.2.

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⁴ As required by Section 386.420.2.

I. Procedure

Before setting forth the substance of its decision, the Commission will explain the procedure by which this decision comes about.

A. Jurisdiction and Authority

This case began with the filing of a letter, requesting a rate increase, from Indian Hills.⁵ Indian Hills is within the Commission's jurisdiction because Indian Hills sells water to customers in Crawford County, Missouri,⁶ and is a public utility⁷ and a water corporation.⁸⁹ The Commission has authority to determine the content of Indian Hills' tariffs,¹⁰ and the parties present competing positions on multiple issues seeking to persuade the Commission to order compliance tariffs in line with their positions.¹¹

B. Law and Policy

The Commission must order tariffs that provide safe and adequate service¹² at rates that are just and reasonable.¹³ The "just and reasonable" standard codifies constitutional provisions that protect the property interests of Indian Hills.¹⁴ Indian Hills' rates must also be as "just and reasonable" to consumers as they are to the utility.¹⁵

⁵ EFIS No. 1 (April 4, 2017).

⁶ EFIS No. 140 (December 7, 2017) *Exhibit No. 212 - Direct Testimony of Geoff Marke* page 3 line 21.

⁷ Section 386.020(43).

⁸ Section 386.020(59).

⁹ Section 393.140(11).

¹⁰ Section 393.140(5) and (11).

¹¹ Section 393.140(11).

¹² Section 393.130.1.

¹³ Section 393.130.1; and Section 393.150.2.

¹⁴ *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of the State of West Virginia*, 262 U.S. 679, 690 (1923).

¹⁵ *Valley Sewage Co. v. Public Service Comm'n* 515 S.W.2d 845, 851 (Mo. App., K.C.D. 1974).

The General Assembly has instructed the Commission to construe the statutes “liberally . . . with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities.”¹⁶

The balance of investor interests and consumer interests does not appear in any single statute or judicially-made formula,¹⁷ but in the pragmatic adjustments that are the Commission’s means to establish just and reasonable rates that ensure safe and adequate service.¹⁸ The Commission must decide this action on consideration of “all facts which in its judgment have any bearing”¹⁹ (sometimes called “all relevant factors”).²⁰

All parties’ expert witnesses on rates employed a collection of financial, accounting, and economic analyses known as cost-of-service rate-making, which the Commission will use in its determinations. Cost-of-service rate-making determines Indian Hills’ rates by calculating Indian Hills’ revenue requirement.²¹ The revenue requirement is how much it costs Indian Hills, in operating expenses (“expenses”), and for a return on its capital assets (“rate base”), to provide safe and adequate service, and includes a return sufficient to service debt and equity and continue attracting capital.²² The parties’ evidence on cost of service comes mostly from Staff’s proposed test year of the 12 months between March 2016 and March of 2017, which is probative of Indian

¹⁶ Section 386.610.

¹⁷ **Fed. Power Comm’n v. Hope Nat. Gas Co.**, 320 U.S. 591, 586 (1944).

¹⁸ **Bluefield**, 262 U.S. at 692; **State ex rel. Associated Natural Gas Co. v. Public. Serv. Comm’n**, 706 S.W.2d 870, 873 (Mo. App., W.D. 1985) (citing **Hope Natural Gas Co.**, 320 U.S. at 602 - 03).

¹⁹ Section 393.270.4.

²⁰ **State ex rel. Util. Consumers’ Council of Missouri, Inc. v. Pub. Serv. Comm’n**, 585 S.W.2d 41, 56 (Mo. banc 1979).

²¹ **Hope Natural Gas Co.**, 320 U.S. at 603 (1944).

²² **Hope Natural Gas Co.**, 320 U.S. at 603 (1944).

Hills' cost of service.²³ The Commission did not set a test year, update period, or true-up dates for this case.

C. Procedural History

The above principles of law and policy apply to the thousands of line items that constitute a public utility's budget, and other operational considerations that must be the subject of tariffs. Those matters develop into issues for the Commission's determination as prescribed by the Commission's regulations.²⁴ The Commission's regulations provide that Indian Hills' letter initiated a small utility rate case.²⁵ A small utility rate case may proceed informally as a non-contested case,²⁶ or formally as a contested case,²⁷ or as both a non-contested case and a contested case in succession as it did here.

Indian Hills and the Commission's staff ("Staff")²⁸ filed a partial disposition agreement setting forth provisions for a partial settlement between Indian Hills and Staff.²⁹ The Office of the Public Counsel ("OPC")³⁰ filed a response stating that OPC

²³ EFIS No. 100 (December 7, 2017) *Exhibit No. 7 - Direct Testimony of Todd Thomas* page 6 line 18.

²⁴ Section 386.410.1.

²⁵ 4 CSR 240-3.050.

²⁶ 4 CSR 240-3.050(14) and (15). Section 393.150.1 provides that the Commission may suspend tariffs pending a pre-decision hearing, which indicates a contested case, but no tariffs are pending. Otherwise, no evidentiary hearing, and therefore, no contested case, is required unless a party asks for an evidentiary hearing. ***State ex rel. Rex Deffenderfer Ent., Inc. v. Public Serv. Comm'n***, 776 S.W.2d 494, 496 (Mo. App., W.D. 1989).

²⁷ 4 CSR 240-3.050(21).

²⁸ Staff is a party to every action before the Commission. 4 CSR 240-2.010(10).

²⁹ EFIS No. 14 (September 1, 2017) *Partial Disposition Agreement and Request for Evidentiary Hearing*.

³⁰ OPC is a party to every action before the Commission. 4 CSR 240-2.010(10).

objected to the partial disposition agreement.³¹ Both the partial disposition agreement and the response included requests for an evidentiary hearing.³²

The Commission issued a notice of contested case.³³ Pursuant to the Commission's scheduling order³⁴ as suggested by the parties,³⁵ the parties prepared a joint list of issues, which Staff filed on behalf of all parties.³⁶ The parties separately filed position statements³⁷ conforming to the list of issues.

Indian Hills and Staff then filed a *Non-Unanimous Stipulation and Agreement*.³⁸ The *Non-Unanimous Stipulation and Agreement* did three things. First, the *Non-Unanimous Stipulation and Agreement* incorporated the partial disposition agreement.³⁹ Second, the *Non-Unanimous Stipulation and Agreement* resolved all remaining disputes between Indian Hills and Staff. The *Non-Unanimous Stipulation and Agreement*

³¹ EFIS No. 18 (September 11, 2017) *Response of the Office of the Public Counsel to Partial Disposition Agreement and Request for Evidentiary Hearing*.

³² Regulation 4 CSR 240-3.050(20) required OPC's response to "include a specified list of issues that [OPC] believes should be the subject of the hearing."

³³ EFIS No. 15 (September 5, 2017) *Notice of Contested Case and Order Directing Filings*.

³⁴ EFIS No. 28 (September 27, 2017) *Amended Notice of Hearing, and Order Establishing Procedural Schedule and Governing Procedure*, page 1, last line.

³⁵ EFIS No. 20 (September 19, 2017) *Motion for Joint Proposed Procedural Schedule*, page 3, tenth line.

³⁶ EFIS No. 81 (November 21, 2017) *List of Issues, Order of Witnesses, Order of Cross - Examination and Order of Opening*. The issues list appears at the later end of the process because the parties cannot know any sooner which of the thousands of line items in a public utility's budget, and other operational considerations that must be the subject of tariffs, will be at issue until after extensive discovery and intensive discussion.

³⁷ EFIS No. 82 (November 21, 2017) *Indian Hills Statement of Position*. EFIS No. 83 (November 21, 2017) *OPC Position Statement*. EFIS No. 84 (November 21, 2017) *[Staff's] Statement of Positions*. A position statement is a "writing filed whereby affirmative relief is sought" so each such filing sets forth "what relief is sought or proposed and the reason for granting it" as Section 536.063(2) requires in a contested case.

³⁸ EFIS No. 87 (November 22, 2017) *Non-Unanimous Stipulation and Agreement*.

³⁹ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 394 line 1, through line 3.

expressly incorporates⁴⁰ the amounts specified in the *Non-Unanimous Stipulation and Agreement's* Attachment B. That Attachment B sets forth the same amounts for each issue, with two exceptions discussed below, as in the prepared testimony of Staff witnesses entered as exhibits at the evidentiary hearing.⁴¹ In agreeing to those amounts, Indian Hills has agreed with Staff's position statement, except as otherwise specified in the *Non-Unanimous Stipulation and Agreement*.

Third, the *Non-Unanimous Stipulation and Agreement* set forth relief not previously raised in the position statements of either Indian Hills or Staff ("new positions"), but now sought by both Indian Hills and Staff, on matters in the issues list. The Commission will address new positions under the issues to which they relate.

OPC filed an objection⁴² to the *Non-Unanimous Stipulation and Agreement*, so the *Non-Unanimous Stipulation and Agreement* did not resolve any issues, but constitutes the joint amended position statement of Indian Hills and Staff⁴³ ("Indian Hills and Staff"). The entire issues list remains in dispute, as framed between the Indian Hills and Staff and the OPC position statement.⁴⁴

The Commission convened a public hearing in Indian Hills' service territory⁴⁵ and an evidentiary hearing at the Commission's offices in Jefferson City.⁴⁶ The parties filed

⁴⁰ EFIS No. 87 (November 22, 2017) *Non-Unanimous Stipulation and Agreement*, page 5 paragraph 9.

⁴¹ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 383 line 16, through page 384 line 3; page 393 line 17, through line 25.

⁴² EFIS No. 88 (November 22, 2017) *Objection and Response to Non-Unanimous Stipulation and Agreement*.

⁴³ 4 CSR 240-2.115(2)(D).

⁴⁴ 4 CSR 240-2.115(2)(D), second sentence.

⁴⁵ EFIS No. 59 (November 1, 2017) *Transcript Volume 2 (Local Public Hearing - 10-18-17)*.

⁴⁶ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)*. EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)*. EFIS No. 92 (December 5,

testimony from 17 expert witnesses, written argument⁴⁷ in the form of reconciliations,⁴⁸ rate design scenarios⁴⁹ and briefs.⁵⁰

II. General Conclusions of Law

On matters not informally resolved, including positions raised for the first time in the *Non-Unanimous Stipulation and Agreement*, the Commission must separately state its findings of fact.⁵¹ Findings of fact do not include summaries of the evidence, summaries of parties' arguments, ultimate facts, and conclusions of law. Findings of fact resolve disputes of material fact—the facts that guide the Commission's conclusions of law.⁵²

As to any one issue, more than one party's position may support safe and adequate service at just and reasonable rates. When that happens, the Commission must determine which position, or parts of positions, best support safe and adequate service at just and reasonable rates.

The Commission has made each determination on consideration of all position statements, authorities applicable to those position statements, and evidence relevant under those authorities. Where the evidence conflicts, the Commission determines which evidence is the most credible. Credibility determinations are implicit in the

2017) *Transcript - Volume 5 In-Camera (Evidentiary Hearing 11-28-17)*. EFIS No. 93 (December 5, 2017) *Transcript - Volume 6 (Evidentiary Hearing 11 - 30 - 17)*.

⁴⁷ Section 536.080.

⁴⁸ EFIS No. 77 (November 17, 2017) *Reconciliation*.

⁴⁹ EFIS No. 179 (January 16, 2017) *Rate Design Scenarios*.

⁵⁰ EFIS No. 175 (January 4, 2018) *[Staff's] Post - Hearing Brief and [Staff's Proposed] Findings of Fact and Discussion*. EFIS No. 176 (January 4, 2018) *Brief of the Office of Public Counsel*. EFIS No. 177 (January 4, 2018) *Indian Hills' Brief*.

⁵¹ Section 536.090.

⁵² ***State ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n***, 24 S.W.3d 243, 246 (Mo. App., W.D. 2000).

Commission's findings of fact,⁵³ and no law requires the Commission to expound upon which portions of the record the Commission accepted or rejected.⁵⁴ When any evidence or argument is not discussed in this report and order, that does not indicate that the Commission has failed to consider such evidence or argument, it indicates that the evidence or argument is not dispositive of any issue.

The quantum of proof necessary to carry a burden of proof in an administrative action is a preponderance.⁵⁵ Preponderance means greater weight in persuasive value.⁵⁶ That means that a claimant must show that the claimant's evidence, and reasonable inferences from the evidence,⁵⁷ weighs more in favor⁵⁸ of the claimant's position than against claimant's position.⁵⁹ As to whether an increased rate is just and reasonable, Indian Hills has the burden of proof.⁶⁰

As to all issues, the following findings of fact apply generally.

III. General Findings of Fact

1. Indian Hills sells about 25,740,000 gallons of water per year to 715 customers⁶¹ in Crawford County, Missouri. Of Indian Hills' customers, half are full-time residents and half are part-time residents.⁶² Part-time residents are those who have a

⁵³ **Stone v. Missouri Dept. of Health & Senior Services**, 350 S.W.3d 14, 26 (Mo. banc 2011).

⁵⁴ **Stith v. Lakin**, 129 S.W.3d 912, 919 (Mo. App., S.D. 2004).

⁵⁵ **State Board of Nursing v. Berry**, 32 S.W.3d 638, 642 (Mo. App., W.D. 2000).

⁵⁶ **State v. Davis**, 422 S.W.3d 458, 464 (Mo. App., E.D. 2014).

⁵⁷ **Farnham v. Boone**, 431 S.W.2d 154 (Mo. 1968).

⁵⁸ **State Board of Nursing v. Berry**, 32 S.W.3d 638, 642 (Mo. App., W.D. 2000).

⁵⁹ **Hager v. Director of Revenue**, 284 S.W.3d 192, 197 (Mo. App., S.D. 2009).

⁶⁰ Section 393.150.

⁶¹ EFIS No. 116 (December 7, 2017) *Direct Testimony of Ashley Sarver* page 2, line 14, through line 17.

⁶² EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 9 line 19, through line 23.

primary residence outside Indian Hills' service territory and for whom a residence in Indian Hills' service territory is a second home.⁶³

Corporate Structure⁶⁴

2. Central States Water Resources, Inc. manages First Round CSWR, LLC.⁶⁵ First Round CSWR, LLC owns holding companies that own Indian Hills and other public utilities: Hillcrest Utility Operating Company, Inc., ("Hillcrest") Raccoon Creek Utility Operating Company, Inc., and Elm Hills Utility Operating Company.⁶⁶

3. Since March of 2015, First Round CSWR, LLC and its subsidiaries have:
- a. Purchased five wastewater treatment plants with associated sewer pumping stations, gravity force mains, and gravity conveyance lines.⁶⁷
 - b. Designed, permitted, and completed construction, with Missouri Department of Natural Resources ("MDNR") approval, of approximately \$2.4 million of sanitary sewer systems since March of 2015.⁶⁸
 - c. Designed, permitted, and completed construction of major wastewater improvements for two wastewater systems that Elm Hills Utility Operating Company, Inc. acquired.⁶⁹ Those systems had been in receivership for approximately ten years and had Missouri Attorney

⁶³ EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 9 line 19, through line 23.

⁶⁴ All limited liability companies ("LLC") in these findings of fact are Missouri LLCs, except Fresh Start Ventures, LLC, which is a Nevada LLC. All corporations listed in these findings of fact are Missouri corporations.

⁶⁵ EFIS No. 94 (December 7, 2017) *Direct Testimony of Josiah Cox, Inc.* page 9 line 17, through line 18.

⁶⁶ EFIS No. 94 (December 7, 2017) *Direct Testimony of Josiah Cox, Inc.* page 3 line 9, through line 13.

⁶⁷ EFIS No. 94 (December 7, 2017) *Direct Testimony of Josiah Cox, Inc.* page 4 line 4, through line 6.

⁶⁸ EFIS No. 94 (December 7, 2017) *Direct Testimony of Josiah Cox, Inc.* page 4 line 6, through page 5 line 2.

⁶⁹ EFIS No. 94 (December 7, 2017) *Direct Testimony of Josiah Cox, Inc.* page 5 line 2, through line 11.

General enforcement actions pending.⁷⁰ For example, Elm Hills Utility Operating Company, Inc. recently obtained Commission approval to acquire a water company and sewer company that had been in Missouri state-appointed receivership for about ten years and had AG enforcement actions pending.⁷¹

- d. Designed, permitted, and completed construction with MDNR approval of approximately \$2.6 million of drinking water systems.⁷²

4. First Round CSWR, LLC also owns Confluence Rivers Utility Operating Company, Inc., which has filed an application with the Commission to acquire several water companies and several sewer companies, alleging various states of distress among those companies.⁷³

⁷⁰ EFIS No. 94 (December 7, 2017) *Direct Testimony of Josiah Cox, Inc.* page 5 line 2, through line 11; page 7 line 5, through line 11.

⁷¹ File No. SM-2017-0150, ***In the Matter of the Application of Elm Hills Utility Operating Company, Inc., and Missouri Utilities Company for Elm Hills to Acquire Certain Water and Sewer Assets of Missouri Utilities Company, for a Certificate of Convenience and Necessity, and, in Connection Therewith, to Issue Indebtedness and Encumber Assets.***

⁷² EFIS No. 94 (December 7, 2017) *Direct Testimony of Josiah Cox, Inc.* page 5 line 12, through page 6 line 5.

⁷³ File No. WM-2018-0116 EFIS No. 1 (November 2, 2017) *Application and Motion for Waiver, In the Matter of the Application of Confluence Rivers Utility Operating Company, Inc. to Acquire Certain Water and Sewer Assets, For a Certificate of Convenience and Necessity, and, in Connection Therewith, To Issue Indebtedness and Encumber Assets.* File No. SM-2018-0117, EFIS No. 1 (November 2, 2017) *Application and Motion for Waiver, In the Matter of the Application of Confluence Rivers Utility Operating Company, Inc. to Acquire Certain Water and Sewer Assets, For a Certificate of Convenience and Necessity, and, in Connection Therewith, To Issue Indebtedness and Encumber Assets.*

The Indian Hills System

5. The physical plant through which Indian Hills delivers water to its customers (“the system”) is approximately 50 years old.⁷⁴ From the system’s construction through 2017, no major capital improvements occurred.⁷⁵ By report dated August 25, 2014, MDNR cited 27 deficiencies in compliance with drinking water standards.⁷⁶

6. The Commission authorized Indian Hills to buy the system,⁷⁷ operate it,⁷⁸ and encumber it for financing improvements bringing the system into regulatory compliance (“the acquisition case”).⁷⁹ On March 31, 2016,⁸⁰ Indian Hills bought the system from I.H. Utilities, Inc.

⁷⁴ EFIS No. 94 *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 11 line 16, through line 17.

⁷⁵ EFIS No. 94 *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 11 line 17, through line 18.

⁷⁶ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* Schedule JC-01.

⁷⁷ File No. WO-2016-0045, EFIS No. 14 (February 3, 2016) *Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity Commission* page 6 paragraph 2, ***In the Matter of the Application of Indian Hills Utility Operating Company, Inc. to Acquire Certain Water Assets of I. H. Utilities, Inc. and, in Connection Therewith, Issue Indebtedness and Encumber Assets.***

⁷⁸ File No. WO-2016-0045, EFIS No. 14 (February 3, 2016) *Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity Commission* page 6 paragraph 1, ***In the Matter of the Application of Indian Hills Utility Operating Company, Inc. to Acquire Certain Water Assets of I. H. Utilities, Inc. and, in Connection Therewith, Issue Indebtedness and Encumber Assets.***

⁷⁹ File No. WO-2016-0045, EFIS No. 14 (February 3, 2016) *Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity Commission* page 8 paragraph 17, ***In the Matter of the Application of Indian Hills Utility Operating Company, Inc. to Acquire Certain Water Assets of I. H. Utilities, Inc. and, in Connection Therewith, Issue Indebtedness and Encumber Assets.***

⁸⁰ EFIS No. 94 *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 1 line 12, through line 13.

7. In the acquisition case, the Commission ordered that the financing allowed in that case be used solely for buying the system and improving plant. But Indian Hills commingled those moneys with other Glarner entities.⁸¹

8. When Indian Hills acquired the system, the system was not in compliance with MDNR standards related to the following.⁸²

- a. Only one well in service. For drinking water systems serving over 500 individuals, MDNR's design guides require at least two wells.⁸³
- b. Reliability. There was no backup power or backup pumping system.⁸⁴
- c. Water loss. The system was losing about 75 percent of all the water it pumped to line leakage.⁸⁵
- d. Insufficient pressure. MDNR requires a minimum water pressure of 21 psi, with a guideline of 35 psi for residential drinking water systems. At the time of acquisition, the system had maximum psi of 20 at the back of

⁸¹ EFIS No. 204 *Surrebuttal Testimony of Keri Roth (Public)* page 2 line 12, through line 18. File No. WO-2016-0045, EFIS No. 14 (February 3, 2016) *Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity* page 9 paragraph 21, ***In the Matter of the Application of Indian Hills Utility Operating Company, Inc. to Acquire Certain Water Assets of I. H. Utilities, Inc. and, in Connection Therewith, Issue Indebtedness and Encumber Assets.***

⁸² EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 11, line 18, through line 21.

⁸³ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 12 line 1, through line 9.

⁸⁴ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 12 line 11, through 17.

⁸⁵ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 12 line 19, through page 13 line 10.

the lake community and, during peak usage, no water pressure at all in that area.⁸⁶

- e. No redundant booster pump. If the only pump failed, the entire system would fail.⁸⁷
- f. Insufficient storage. The system had only 20,000 gallons of storage for a system that averaged around 180,000 per day during the summer months.⁸⁸

9. To rectify those issues, bring the system into MDNR compliance, and to provide safe and adequate service, Indian Hills has invested approximately \$1.84 million in the system.⁸⁹ By report dated November 4, 2016, MDNR found that the system was in compliance with drinking water standards.⁹⁰ Indian Hills completed remaining improvements by February 2017.⁹¹

10. The improvements include the following:

- a. An additional well.⁹²

⁸⁶ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 1 line 1, through line 12.

⁸⁷ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 14 line 14, through line 17.

⁸⁸ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 14 line 19, through page 15 line 7.

⁸⁹ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 26 line 4, through line 11.

⁹⁰ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* Schedule JC-02.

⁹¹ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 21 line 11.

⁹² EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 20 line 1, through line 2.

- b. Two new well houses with improved and standby disinfection and chlorination systems.⁹³
- c. A backup generator for system reliability.⁹⁴
- d. Two new storage tanks.⁹⁵
- e. Booster pumps to maintain minimum system pressure.⁹⁶

11. A substantial rebuild is still underway to provide safe and adequate water service to Indian Hills' customers and comply with federal and state regulations related to those services.⁹⁷

Operations

12. Smaller water utilities, especially distressed small water utilities, are particularly difficult to permit, build, and operate; they require more expertise and executive level skills than larger utilities because every employee needs to have expertise in multiple areas.⁹⁸

⁹³ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 18 line 8, through line 21; page 20 line 12, through page 21 line 3.

EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 17.),

⁹⁴ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 19 line 19, through line 23.

EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 16.

⁹⁵ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 19 line 11, through line 12; page 20 line 7, through line 9.

⁹⁶ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 20 line 22, through page 21 line 1.

⁹⁷ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 22, line 6, through line 11.

⁹⁸ EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 7 line 5, through line 12. EFIS No. 100 (December 7, 2017) *Exhibit No. 7 - Direct Testimony of Todd Thomas* page 8 line 19, through page 9 line 19.

13. Since October 27, 2009, Indian Hills' current rates have consisted of a base charge of \$10.81 that includes 4,000 gallons and a volumetric rate of \$1.89 for every 1,000 gallons over 4,000 gallons. Indian Hills collects about \$97,291 annually in revenue.⁹⁹ The costs incorporated into the *Non-Unanimous Stipulation and Agreement* come from Staff's audit of Indian Hills' costs from March 2016 through March 2017 ("Staff's test year").¹⁰⁰

IV. Disputed Issues

As noted above the parties submitted a List of Issues that will be addressed in order below, along with specific findings of facts that relate more specifically to each issue.

A. Expenses

The parties dispute whether and to what extent the Commission should include the following costs and expenses in Indian Hills' rate base.

i. Payroll.

The Commission is ordering that Indian Hills' compliance tariffs shall include amounts in rates and charges for the salaries of Josiah Cox and Todd Thomas as sought by Indian Hills and Staff. The issues list and the prevailing position statement use the following language.

- a. *What are the appropriate job titles to be used in [Missouri Economic Research and Information Center ("MERIC")] to compare and determine labor expense associated with Mr. Josiah Cox and Mr. Todd Thomas?*
 - *[T]he appropriate job title for MERIC purposes for Mr. Josiah Cox is Chief Executive and*

⁹⁹ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 21 line 22 , through page 23 line 2.

¹⁰⁰ EFIS No. 100 (December 7, 2017) *Exhibit No. 7 - Direct Testimony of Todd Thomas* page 6 line 18.

- *[T]he appropriate job title for MERIC purposes [is] Construction Manager for Mr. Todd Thomas.*
- b. *What are the appropriate MERIC salary or wages?*
- *[Josiah Cox: 2013 amount.]*
 - *[Todd Thomas: 2015 amount.]*
- c. *Should the Employment Cost Index inflation rate be applied in setting such amounts?*
- *No.*
- d. *What allocation factor (actual or assumed) should be used to determine payroll?*
- *An assumed allocation factor to determine payroll [of 16.61 percent].*
- e. *What level of experience should be used to set the labor expense associated with each employee?*
- *[T]he mean level of experience in the Missouri Economic Research and Information Center (MERIC) to annualize CSWR payroll.*

Findings of Fact

1. The standard for measuring employee salaries is the data of the Missouri Economic Research and Information Center (“MERIC”), an office within the Missouri Department of Economic Development.¹⁰¹ MERIC classifies employees under job titles according to employee duties.¹⁰² MERIC also breaks down salaries for job titles by geographical region.¹⁰³ The relevant geographic region for Indian Hills’ employees is St. Louis, Missouri.¹⁰⁴

2. MERIC further breaks salary amounts down for any job title by experience level into entry, mean, and experienced; entry is the lowest, experienced is the highest

¹⁰¹ EFIS No. 116 (December 7, 2017) *Exhibit No. 104 - Direct Testimony of Ashley Sarver* page 3 line 9, through line 14.

¹⁰² EFIS No. 8 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias* page 10 line 16, through line 18.

¹⁰³ EFIS No. 116 (December 7, 2017) *Exhibit No. 104 - Direct Testimony of Ashley Sarver* page 2 line 18, through line 20.

¹⁰⁴ EFIS No. 122 (December 7, 2017) *Exhibit No. 110 - Rebuttal Testimony of Ashley Sarver* page 10 line 7, through line 9.

and the intermediate is the mean.¹⁰⁵ Mean level describes employees of at least three and one half years' experience. All the employees of First Round CSWR, LLC have the mean level of experience in the business of running a water company.¹⁰⁶

3. Indian Hills has no employees of its own and acts through six employees of First Round CSWR, LLC,¹⁰⁷ including Mr. Josiah Cox and Mr. Todd Thomas.

4. For First Round CSWR, LLC, and its subsidiaries including Indian Hills, Josiah Cox and Todd Thomas both act as contact for financial regulatory compliance with Staff and OPC, and as contact for environmental regulatory compliance with the MDNR and the Missouri Attorney General.¹⁰⁸

5. The MERIC job title of General and Operations Manager signifies formulating policies, and diverse daily operations too general in nature to be classified in any one functional area.¹⁰⁹

6. In addition to the responsibilities of General and Operations Manager, Josiah Cox's responsibilities to First Round CSWR, LLC and its subsidiaries, including Indian Hills, include acting as leader and director of overall company strategy and direction, and director of all financing activities including debt and equity increases.¹¹⁰

¹⁰⁵ EFIS No. 116 (December 7, 2017) *Exhibit No. 104, Direct Testimony of Ashley Sarver* page 4 line 1, through line 7.

¹⁰⁶ EFIS No. 130 (December 7, 2017) *Exhibit No. 202 - Rebuttal Testimony of Keri Roth*, page 8 line 13, through line 15.

¹⁰⁷ EFIS No. 116 (December 7, 2017) *Exhibit No. 104 - Direct Testimony of Ashley Sarver* page 2 line 18, through line 20.

¹⁰⁸ EFIS No. 129 (December 7, 2017) *Exhibit. 201 - Direct Testimony of Keri Roth*, page 4 line 6, through line 26.

¹⁰⁹ EFIS No. 102 (December 7, 2017) *Exhibit No. 9 - Surrebuttal Testimony of Todd Thomas* page 4 line 10 through line 14.

¹¹⁰ EFIS No. 129 (December 7, 2017) *Exhibit. 201 - Direct Testimony of Keri Roth*, page 4 line 6, through line 26.

In addition, Josiah Cox has done significant work in utility acquisition, including evaluating existing utility assets for acquisition, determining existing net book value of acquisition targets, and selecting engineering design and technology. Josiah Cox has also been responsible for ongoing operations and management, including monitoring all plant remote operations and emergency responses, new utility rate design and proforma financial models, and overall company-wide management across multiple states.¹¹¹ The MERIC job title matching Josiah Cox's responsibilities is Chief Executive.¹¹²

7. Todd Thomas' responsibilities to First Round CSWR, LLC and its subsidiaries including Indian Hills, are: utility acquisitions, construction and engineering management, third party contractor acquisition and contract negotiation and management.¹¹³ The MERIC job title best matching Todd Thomas' responsibilities is Construction Manager.¹¹⁴

8. The most recent MERIC salary data is for 2016. To keep MERIC salary data accurate between rate cases, salary data within one year of a test year is sufficiently current that no inflationary factor is necessary.¹¹⁵ However, significant fluctuations in

¹¹¹ EFIS No. 97 (December 7, 2017) *Exhibit No. 4 - Direct Testimony of Phil Macias* page 13 line 16, through page 14 line 2.

¹¹² EFIS No. 101 (December 7, 2017) *Exhibit 101 - Rebuttal Testimony of Todd Thomas on Behalf of Indian Hills Utility Operations Company* page 7 line 20 through line 21.

¹¹³ EFIS No. 129 (December 7, 2017) *Exhibit 201 - Direct Testimony of Keri Roth*, page 4 line 6, through line 26.

¹¹⁴ EFIS No. 122 (December 7, 2017) *Exhibit 110 - Rebuttal Testimony of Ashley Sarver* page 8 line 20, through page 9 line 2.

¹¹⁵ EFIS No. 130 (December 7, 2017) *Exhibit No. 202 - Rebuttal Testimony of Keri Roth*, page 8 line 5, through line 12.

salaries have occurred since 2013, almost \$10,000 over two years for some job titles.¹¹⁶ When costs are fluctuating from year to year, a single year may represent a peak or a valley, so reliance on an anomalous year will distort rates.¹¹⁷ To avoid that result, and better determine the cost of service for just and reasonable rates, two methods are available.

9. One method is to pick a year outside the fluctuations.¹¹⁸ For Josiah Cox, the Commission applied the 2013 salary for Chief Executive of mean experience in two recent cases setting the rates of First Round CSWR, LLC subsidiaries.¹¹⁹ Use of 2013 MERIC salary for Josiah Cox also avoids having to account for significant fluctuations in the MERIC wage levels shown in subsequent years for these employees' job categories.¹²⁰ Consistency among the subsidiaries of First Round CSWR, LLC also favors using the 2013 amount.

10. The other method is to normalize expenses by averaging years¹²¹ ("normalizing"). Todd Thomas has not been with First Round CSWR, LLC long enough to make the 2013 MERIC salary accurate for him. Normalization is more accurate, and

¹¹⁶ EFIS No. 122 (December 7, 2017) *Exhibit 110 - Rebuttal Testimony of Ashley Sarver* page 7 line 24, through page 8 line 4.

¹¹⁷ EFIS No. 116 (December 7, 2017) *Exhibit No. 104 - Direct Testimony of Ashley Sarver* page 4 line 17, through line 19.

¹¹⁸ EFIS No. 116 (December 7, 2017) *Exhibit No. 104 - Direct Testimony of Ashley Sarver* page 4 line 17, through line 19.

¹¹⁹ ***In the Matter of the Water Rate Increase Request of Hillcrest Utility Operating Company, Inc.***, File No. WR-2016-0064. File No. SR-2016-0202, ***In the Matter of the Application of a Rate Increase for Raccoon Creek Utility Operating Company Inc.*** EFIS No. 116 (December 7, 2017) *Exhibit No. 104 - Direct Testimony of Ashley Sarver* page 4 line 12, through line 17.

¹²⁰ EFIS No. 116 (December 7, 2017) *Exhibit No. 104 - Direct Testimony of Ashley Sarver* page 4 line 8, through line 19.

¹²¹ EFIS No. 122 (December 7, 2017) *Exhibit No. 110 - Rebuttal Testimony of Ashley Sarver* page 10 line 18, through line 21.

the 2015 mean amount is the amount actually paid for the MERIC job title of Construction Manager that is closest to a three-year average.¹²²

11. First Round CSWR LLC's records show that First Round CSWR LLC employees spend 16.61% of their time on Indian Hills.¹²³

Discussion

All parties agree that MERIC job titles are the standard measure to set the amount of employee compensation that Indian Hills may collect through rates. For Todd Thomas, all parties agree that the most accurate MERIC classification is Construction Manager. For Josiah Cox, the most accurate MERIC classification is in dispute.

OPC argues that the appropriate classification is General Operations Manager because Josiah Cox is merely the top manager of a small utility, and the practice in Missouri is to call such a person the general manager. OPC's argument ignores the undisputed fact that Josiah Cox works not only for Indian Hills, but also for First Round CSWR, LLC, which requires his services as to four water companies and the acquisition of more. OPC implicitly acknowledges this when, as set out below, OPC argues in favor of allocating salary to Indian Hills in proportion to the hours worked on Indian Hills business. That reasoning supported the same conclusion as to Josiah Cox's work for Hillcrest in **Hillcrest Rate Case**,¹²⁴ ("**Hillcrest Rate Case**") and OPC shows no reason to decide otherwise here. The Commission concludes that the appropriate MERIC classification for Josiah Cox is Chief Executive.

¹²² EFIS No. 116 (December 7, 2017) *Exhibit No. 104 - Direct Testimony of Ashley Sarver* page 5 Line 7 through line 8.

¹²³ EFIS No. 129 (December 7, 2017) *Exhibit No. 201, Direct Testimony of Keri Roth* page 5 line 2, through line 9.

¹²⁴ File No. WR-2016-0064, EFIS No. 93 (July 12, 2016) *Report and Order*, page 16, ***In the Matter of the Water Rate Increase Request of Hillcrest Utility Operating Company, Inc.***,

As to MERIC experience levels, the parties agree, and the Commission concludes, that the years of experience of First Round CSWR, LLC employees in the water company business support a mean experience level. The Commission concludes that the mean experience level is appropriate.

As to the appropriate years for salaries and an inflation index, Indian Hills and Staff do not seek an inflation index. OPC also argues that the Commission should use no inflation index because OPC favors 2016 salary amounts, which are sufficiently recent to be accurate without inflation. And, at least as to Todd Thomas, normalization, for which his 2015 salary level substitutes, is more accurate than the 2016 data, so it requires an inflation factor even less than 2016 data. The Commission concludes that a straight application of 2016 MERIC salary levels is inaccurate for the salaries of Josiah Cox and Todd Thomas. The Commission concludes that the 2013 level for Josiah Cox and the 2015 level for Todd Thomas will support safe and adequate service at just and reasonable rates.

As to an allocation factor to apportion First Round CSWR, LLC employee time to Indian Hills, the parties argue that the most accurate method is by time records, which show that First Round CSWR, LLC employees spend 16.61 percent of their time on Indian Hills. The Commission concludes that the allocation factor of 16.61 percent reflects the proportion of employees' time spent on Indian Hills.

Therefore, on the issue of payroll, the Commission will order the filing of compliance tariffs according to Indian Hills and Staff.

ii. Auditing and Tax Preparation Fee

The Commission is ordering that Indian Hills' compliance tariffs shall include amounts in rates and charges for the auditing and tax preparation fees that Indian Hills pays to First Round CSWR, LLC as sought by Indian Hills and Staff. The issues list and the prevailing position statement use the following language.

a. What is the appropriate amount of Indian Hill's auditing and tax preparation (accounting) costs to include in Indian Hill's cost of service?

- \$13,993.

b. Should accounting costs paid outside the test year be included in Indian Hill's cost of service?

- Yes.

Findings of Fact

1. Standard practices for measuring just and reasonable rates include matching a public utility's yearly revenue requirement with its yearly cost of service ("matching principle").¹²⁵ Reasonable rates may include known and measurable amounts that did not occur within a test year, but will recur.¹²⁶

2. Preparing tax returns and auditing financial statements is part of any professionally operated utility and even more important for a distressed utility trying to raise capital. Indian Hills must file tax returns.¹²⁷ Indian Hills must have audited financial statements to secure funding from any major government source for water system improvement. A potential source of financing to one of First Round CSWR, LLC's

¹²⁵ EFIS No. 130 (December 7, 2017) *Exhibit No. 202 - Rebuttal Testimony of Keri Roth* page 4 line 11 through line 12.

¹²⁶ EFIS No. 124 (December 7, 2017) *Surrebuttal Testimony of Ashley Sarver* page 3 line 18, through page 4 line 7.

¹²⁷ EFIS No. 90 *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 227 line 4, through line 22.

subsidiaries rejected that subsidiary's application for equipment funding because the subsidiary lacked audited financial statements.¹²⁸

3. First Round CSWR, LLC completed audited financial statements and prepared tax returns ("accounting") for itself and its subsidiaries. First Round CSWR, LLC billed Indian Hills an allocated amount for those accounting services ("accounting costs") before, but received payment after, March 2017.¹²⁹ The accounting costs included one-time retainers of \$500 for the audited financial statements and \$1,250 for the tax preparation, which Indian Hills will not pay again. The remaining accounting costs allocated to Indian Hills total \$13,933,¹³⁰ and that amount will recur yearly.¹³¹

Discussion

The accounting costs are required for Indian Hills. Tax returns are a legal necessity. Audited financial statements are a practical necessity. OPC argues that audited financial statements are not necessary because no Commission regulation includes audited financial statements in cost of service. No authority requires such a regulation to make a cost part of a public utility's revenue requirement. Nevertheless, OPC argues that none of the accounting costs should find their way into Indian Hills' rates and charges. In support, OPC cites the matching principle, and the fact that Indian Hills did not pay the bill for the accounting costs during Staff's proposed

¹²⁸ EFIS No. 94 (December 7, 2017) *Direct Testimony of Josiah Cox* page 23 line 13, through page 24 line 5.

¹²⁹ EFIS No. 90 *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 215 line 7, though line 17.

¹³⁰ EFIS No. 124 (December 7, 2017) *Surrebuttal Testimony of Ashley Sarver* page 2 line 17, through page 3 line 14.

¹³¹ EFIS No. 99 (December 7, 2017) *Exhibit No. 6 - Surrebuttal Testimony of Phil Macias* page 6 line 19 though line 23.

test year. Unlike some other Commission cases,¹³² the Commission did not issue an order that set a test year, update period, or true-up dates for this case. Even if the Commission ordered a test year in this case, such an order does not inflexibly exclude costs paid¹³³ outside the test year, if the amounts support safe and adequate service, are known, and are measurable. Just and reasonable rates include such amounts.¹³⁴

In the alternative to excluding the accounting costs, OPC asks the Commission for the same relief as Indian Hills and Staff. That request is to include Indian Hills' allocated accounting costs, less the non-recurring retainers, in Indian Hills' rates and charges.

The Commission concludes that paying the accounting services outside Staff's test year does not require excluding the accounting costs from Indian Hills' rates and charges.

Therefore, on the issue of auditing and tax preparation fees, the Commission will order the filing of compliance tariffs according to Indian Hills and Staff.

iii. Management Consulting Fees

The Commission is ordering that Indian Hills' compliance tariffs shall include an amount in rates and charges for management consulting fees that Indian Hills pays to

¹³² See, for example, File No. GR - 2014 - 0086, EFIS No. 15 (January 23, 2014) *Order Determining Test Year, Update, and True-Up*, issued on January 23, 2014, ***In the Matter of Summit Natural Gas of Missouri Inc.'s Filing of Revised Tariffs To Increase its Annual Revenues For Natural Gas Service.***

¹³³ This distinguishes the basis for the Commission's rulings in this action from its ruling in ***Hillcrest Rate Case.*** In ***Hillcrest Rate Case,*** the Commission included in the cost of service no amount for fees that were not known, measurable, and paid. File No. WR-2016-0064 EFIS No. 93 (July 12, 2017) *Report and Order* page 20.

¹³⁴ EFIS No. 124 (December 7, 2017) *Surrebuttal Testimony of Ashley Sarver* page 4 line 5, through line 7.

Lois Stanley as sought by Indian Hills and Staff. The issues list and the prevailing position statement use the following language.

a. *Should a management consulting fee be included in the cost of service for Indian Hills?*

- Yes.

Findings of Fact

1. Indian Hills' infrastructure system includes about 16 miles of pipe,¹³⁵ consists of randomly gauged lines, and is about 50 years old.

2. No tracer wires exist to help locate lines by metal detection.¹³⁶ No map shows the original¹³⁷ or current¹³⁸ location of the system's mains and other infrastructure. Missouri One Call does not have that information because Missouri One Call gets that information from utilities¹³⁹ but Indian Hills' predecessors never gave that information to Missouri One Call.¹⁴⁰ Absent such resources, there are two options for locating infrastructure.

¹³⁵ EFIS No. 95 (December 7, 2017) *Exhibit 2 - Rebuttal Testimony of Josiah Cox* page 18 line 13, through line 15.

¹³⁶ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 238 line 16, through 23.

¹³⁷ EFIS No. 95 (December 7, 2017) *Exhibit 2 - Rebuttal Testimony of Josiah Cox* page 18 line 1, through line 6.

¹³⁸ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 237 line 2, through line 18.

¹³⁹ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 236 line 2, through line 17.

¹⁴⁰ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 245 line 1, through page 246 line 8.

3. The first option is “potholing,” which means digging at random or close to a wet spot.¹⁴¹

4. The second option is to ask Lois Stanley. Ms. Stanley managed the system before Indian Hills bought it.¹⁴² Ms. Stanley knows the infrastructure’s location and operation.¹⁴³ Ms. Stanley locates connections and other undocumented features of the system.¹⁴⁴ For example, Ms. Stanley has located buried valves, which saves Indian Hills the capital investment of installing new isolation valves.¹⁴⁵ Ms. Stanley also knows the location and gauge of lines in places where no one else knew that a line existed.¹⁴⁶

5. Indian Hills has contracted with Ms. Stanley for that service and other applications of her institutional knowledge.¹⁴⁷ Under the contract, Indian Hills pays \$500 per month¹⁴⁸ to Ms. Stanley for her work on an as-needed basis, without regard to how many hours Ms. Stanley works in a month. As a result of this contract, no time sheets

¹⁴¹ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 238 line 16, through page 239 line 1.

¹⁴² EFIS No. 95 (December 7, 2017) *Exhibit 2 - Rebuttal Testimony of Josiah Cox* page 18 line 7, through line 11.

¹⁴³ EFIS No. 95 (December 7, 2017) *Exhibit 2 - Rebuttal Testimony of Josiah Cox* page 18 line 7, through line 11.

¹⁴⁴ EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 3 line 14, through line 16.

¹⁴⁵ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 233 line 6 through 23.

¹⁴⁶ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 238 line 1, through line 15.

¹⁴⁷ EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 3 line 6, through line 8.

¹⁴⁸ EFIS No. 95 (December 7, 2017) *Exhibit 2 - Rebuttal Testimony of Josiah Cox* page 17 line 18, through 22.

are needed or used for her.¹⁴⁹ Indian Hills communicates with Ms. Stanley through Indian Hills' design engineer and operations and maintenance contractor.¹⁵⁰

6. Indian Hills has the option to terminate the contract after three years, but Indian Hills may not terminate the contract because Indian Hills will likely still need to make repairs and replacements and to use Ms. Stanley's expertise on the system in the future.¹⁵¹

Discussion

OPC argues that Indian Hills' contract with Ms. Stanley is merely a method to pay her more than the system is worth, impugns the value of her services, and denigrates the evidence describing Ms. Stanley's usefulness. For example, OPC emphasizes the absence of time sheets, but nothing requires Indian Hills to treat Ms. Stanley like an employee instead of a contractor. Indian Hills has demonstrated the value of Ms. Stanley' services and the Commission's findings of fact reflect the Commission's assessment of the evidence.

Significantly, OPC offers no alternative to Ms. Stanley's institutional memory for locating infrastructure. OPC also argues that Ms. Stanley could convey all the information that Indian Hills needs in less than three years, but no evidence suggests that such a feat is possible. On this record, the only alternative is potholing. Indian Hills has shown that contracting with Ms. Stanley, to locate lines before digging, is more

¹⁴⁹ EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 3 line 3, through line 5.

¹⁵⁰ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 237 line 19, through 22.

¹⁵¹ EFIS No. 95 (December 7, 2017) *Exhibit 2 - Rebuttal Testimony of Josiah Cox* page 18 line 13, through line 15.

economical than digging blindly. The Commission concludes that the management fee is appropriate to include in this case.

Therefore, on the issue of management and consulting fees, the Commission will order the filing of compliance tariffs according to Indian Hills and Staff.

iv. Bank Fees

The Commission is ordering that Indian Hills' compliance tariffs shall include an amount in rates and charges for the bank fees as sought by Indian Hills and Staff. The issues list and the prevailing position statement use the following language.

a. What is the appropriate level of bank fees to include in the cost of service for Indian Hills?

- *[Twelve] months of bank fees in [Indian Hills'] cost of service totaling \$4,[932].*¹⁵²

Findings of Fact

1. Indian Hills incurs charges for banking services.¹⁵³ The bank service most costly to Indian Hills is "lockbox service"¹⁵⁴ at Enterprise Bank and Trust.¹⁵⁵ Lockbox service means that a bank receives payments directly from a client's customers and records the receipts for the client.¹⁵⁶ Indian Hills receives a high quantity of low dollar

¹⁵² EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 202 line 4, through 11.

¹⁵³ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 11 line 19, through 20.

¹⁵⁴ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 250 line 19, through 21.

¹⁵⁵ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 11 line 21, through 22.

¹⁵⁶ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 12 line 2, through 4.

payments, the processing of which is a time consuming and labor-intensive process,¹⁵⁷ and lockbox is a common service¹⁵⁸ for addressing that challenge, because it offers several advantages to in-house processing.

2. The advantages of a lockbox service include much faster processing of payments,¹⁵⁹ which speeds up cash flow.¹⁶⁰ Cash flow is vital to meet the ongoing maintenance and repair of a small system.¹⁶¹

3. Also, that processing happens under the rigid process controls of a bank, which reduce the inherent risks associated with cash receipts.¹⁶² In September 2017, the lockbox for Indian Hills' lockbox service processed 449 transactions; and the lockboxes for all CSWR First Round, LLC subsidiaries processed 1,165 transactions, all without error.¹⁶³ No error has occurred in two and one-half years of CSWR First Round, LLC using that subsystem.¹⁶⁴

¹⁵⁷ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 12 line 10, through line 12.

¹⁵⁸ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 250 line 23, through page 251 line 3.

¹⁵⁹ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 12 line 5, through line 6.

¹⁶⁰ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 12 line 5, through line 6.

¹⁶¹ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 251 line 15, through line 18.

¹⁶² EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 12 line 7, through line 9.

¹⁶³ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 13 line 1, through line 4.

¹⁶⁴ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 13 line 4, line through 6.

4. Further, when Indian Hills pays for lockbox service, its pays only its actual cost for servicing Indian Hills' customers and not an allocation.¹⁶⁵

Discussion

Indian Hills and Staff argue that the compliance tariffs should include an amount for lockbox service because that amount represents the cost of processing customer payments. Indian Hills must process payments somehow. OPC offers no alternative. Although OPC suggests that self-dealing has inflated the bank fees, OPC has raised no serious doubt as to whether Indian Hills is paying more than an ordinary price for lockbox services.

The provisions of the partial disposition agreement incorporated into the *Non-Unanimous Stipulation and Agreement*, include Indian Hills delivering documentation to Staff showing that Indian Hills has determined whether its bank fees are the most cost effective for Indian Hills by consulting with other banks.¹⁶⁶ That and similar documentation may show that Indian Hills has diligently explored alternative providers for banking services. But without it, any future Commission may conclude that Indian Hills' bank fees do not support safe and adequate service at just and reasonable rates, and may exclude bank fees from Indian Hills' cost of service.

Therefore, on the issue of bank fees, the Commission will order the filing of compliance tariffs according to Indian Hills and Staff.

¹⁶⁵ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 251 line 18, through page 252 line 3.

¹⁶⁶ EFIS No. 87 (November 22, 2017) *Non-Unanimous Stipulation and Agreement* page 2, paragraph a.iv. EFIS No. 14 (September 1, 2017) *Partial Disposition Agreement and Request for Evidentiary Hearing*, Appendix 1: Partial Disposition Agreement of Small Water Revenue Increase Request, page 3 paragraph (4)(d).

v. Rate Case Expense

The Commission is ordering that Indian Hills' compliance tariffs shall include in rates and charges an amount for rate case expense shared between Indian Hills and Indian Hills' customers as sought by Indian Hills and Staff. The issues list and the prevailing position statement use the following language.

- a. What is the appropriate rate case expense to include in the cost of service for Indian Hills?*
- A normalized rate case expense of \$5,722 (includes a five year amortization and a 50/50 sharing of expert witness fees).*

Findings of Fact

1. The relief ordered in this action will benefit Indian Hills, in that Indian Hills will have just and reasonable rates; and will benefit customers, in that customers will have safe and adequate service.¹⁶⁷

2. Pursuing this action required Indian Hills to incur expenses that include consultant fees, expert witness fees, lawyer fees, and the cost of publishing notices to customers.¹⁶⁸

3. During discovery, Indian Hills mistakenly included an invoice for a video presentation shown at the local public hearing.

4. Preparation and presentation of a general rate action is a costly endeavor, as the fees charged by certain expert witnesses show.¹⁶⁹

¹⁶⁷ EFIS No. 123 (December 7, 2017) *Exhibit 111 - Surrebuttal Testimony of Jennifer K. Grisham* page 2 line 16, through line 20.

¹⁶⁸ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 260 line 15, though page 265 line 11.

¹⁶⁹ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 265 line 8, through line 11.

Discussion

The Commission has authority to allocate rate case expense between Indian Hills and its customers.¹⁷⁰ The resulting compliance tariffs will benefit both Indian Hills and its customers, so both Indian Hills and its customers should bear the rate case expense.

Indian Hills and Staff seek a 50/50 split of rate case expense. OPC advocated for a \$250 cap on expert and consultant fees. Indian Hills and Staff proposed to amortize the customer's share over five years, which is within OPC's suggested range.

The Commission concludes that the rate case expense should be allocated using a 50/50 split. A 50/50 allocation reflects the joint benefits and burdens of the rate case. The issues raised were raised equally between the Company and OPC so that an equal sharing is appropriate. A five year amortization results in a lesser amount in rates per year and is reasonable.

Therefore, on the issue of rate case expense, the Commission will order the filing of compliance tariffs according to Indian Hills and Staff.

vi. Leak Repair Costs

The Commission is ordering that Indian Hills' compliance tariffs shall include in rates and charges an amount for initial leak repair cost in the amount of \$90,000 amortized over three years, and future repair expense in operation and maintenance, as argued by Indian Hills and Staff. The issues list and the prevailing position statement use the following language.

¹⁷⁰ *In Matter of Kansas City Power & Light Co.'s Request for Auth. to Implement a Gen. Rate Increase for Elec. Serv. v. Missouri Pub. Serv. Comm'n*, 509 S.W.3d 757, 776 (Mo. App., W.D. 2016).

a. *What are the appropriate accounts to book leak repair?*

- *Booking the initial leak repair cost in rate base and amortizing this amount over three years. Future repair expense should be booked in operation and maintenance accounts.*

b. *What is the appropriate level of leak repair to include in the cost of service?*

- *[\$90,000] included in rate base and amortize this amount three years.*

The Commission is also ordering the new relief sought in the *Non-Unanimous Stipulation and Agreement*:

- *Engineering Study.*
- *Monthly Usage Data.*
- *Repair Expense Tracker.*¹⁷¹

Findings of Fact

1. To comply with environmental regulations, Indian Hills had to increase pressure in its system,¹⁷² which caused 300 leaks in 12 months.¹⁷³ Indian Hills addressed those leaks by doing an average of six repairs per week.¹⁷⁴

2. When Indian Hills does a leak repair, it substitutes a new section of pipe for a leaking section of pipe.¹⁷⁵ When Indian Hills does a replacement, Indian Hills substitutes

¹⁷¹ The tracker is one of two items in Attachment B to the *Non-Unanimous Stipulation and Agreement* that is not supported in Staff's prepared testimony but is supported by live testimony at the evidentiary hearing. EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 383 line 16, through page 384 line 3; page 393 line 17, through line 25. The other is the return on equity percentage.

¹⁷² EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 286 line 3, through line 13.

¹⁷³ EFIS No. 102 (December 7, 2017) *Exhibit No. 9 - Surrebuttal Testimony of Todd Thomas* page 5 line 21, through line 22.

¹⁷⁴ EFIS No. 101 (December 7, 2017) *Exhibit 101 - Rebuttal Testimony of Todd Thomas on Behalf of Indian Hills Utility Operations Company* page 8 line 6, through line 8.

¹⁷⁵ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 316 line 4, through line 15.

new line from the main to the meter.¹⁷⁶ Compared to a repair, pipe replacement takes three or four times as long and replacing a main takes nine or ten times as long, and both interrupt service to customers.¹⁷⁷

3. The condition of Indian Hills' system guarantees that the costs of repair and replacement will continue to accrue.¹⁷⁸

4. Indian Hills spent approximately \$90,000 on repairs between March 2016 and March 2017.¹⁷⁹ Three years is a reasonable time for amortizing that amount.¹⁸⁰ Indian Hills has improved its recordkeeping system for repairs¹⁸¹ to show how much Indian Hills must spend to make repairs or replacements in its system each year.¹⁸² The difference is significant because a replacement is plant in service, which counts as capital in rate base and cannot be accounted for in new rates after it is used and made useful.¹⁸³

¹⁷⁶ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 316 line 2, through line 25.

¹⁷⁷ EFIS No. 102 (December 7, 2017) *Exhibit No. 9 - Surrebuttal Testimony of Todd Thomas* page 6 line 2, through line 11.

¹⁷⁸ EFIS No. 120 (December 7, 2017) *Exhibit No. 108 - Rebuttal Testimony of Jennifer K. Grisham* page 5 line 15, through page 6 line 5.

¹⁷⁹ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 386 line 19, through line 24.

¹⁸⁰ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 389 line 12, through page 390 line 24.

¹⁸¹ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 290 line 5, through page 291, line 16.

¹⁸² EFIS No. 120 (December 7, 2017) *Exhibit No. 108 - Rebuttal Testimony of Jennifer K. Grisham* page 5 line 21, through page 6 line 3.

¹⁸³ EFIS No. 120 (December 7, 2017) *Exhibit No. 108 - Rebuttal Testimony of Jennifer K. Grisham* page 6 line 10, through line 22.

5. A systemic replacement program for system mains and service connections, based on historic repair data and engineering expertise, would help address the leak issue caused by increases in pressure from the required plant upgrades.¹⁸⁴

6. In utility accounting practice, a “tracker” is a provision that sets an amount certain (“baseline”) for a specified line item and directs that amounts above the baseline shall be recorded in a specified account under the Uniform System of Accounts (“USoA”) for consideration at the next rate case. A two-way tracker records both amounts above the baseline and amounts below the baseline.¹⁸⁵ A tracker is useful for monitoring an amount when it is uncertain whether that amount will increase or decrease.¹⁸⁶ The existence of a tracker does not pre-determine rate-making treatment in the next rate case.¹⁸⁷

Discussion

As to the amount for leak repair that Indian Hills should collect in rates, the parties dispute how much of the costs reported as repairs are really replacement of capital items, and how many repeated repairs profited contractors where prudence directed a replacement instead of a repair. The Commission has found the evidence weighs more in favor of Indian Hills and Staff.

¹⁸⁴ EFIS No. 134 (December 7, 2017) *Exhibit No. 206 - Rebuttal Testimony of John A. Robinett* page 4 line 11, through line 20. EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 356 line 10, through line 14.

¹⁸⁵ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 388 line 3, through line 21.

¹⁸⁶ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 392 line 4, through line 15.

¹⁸⁷ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 394 line 16, through line 20.

Pursuant to its statutory authority,¹⁸⁸ the Commission's regulations¹⁸⁹ incorporate USoA published by the National Association of Regulatory Utility Commissioners. Staff cites the provisions of USoA stating that operating expenses include items of maintenance:

Work performed specifically for the purpose of preventing failure, restoring serviceability or maintaining life of plant.
[¹⁹⁰]

That language describes repairs to the system.

OPC argues for a maintenance expense of \$5,198, and for capitalizing \$90,426 in leak repairs. In support, OPC criticizes Indian Hills for the many leaks caused by an increase in pressure. The increase in pressure was necessary to comply with environmental regulations. OPC criticizes Indian Hills for having no plan in place to deal with the resultant leaks, but offers no evidence of how to plan for leaks except by being ready to fix them when they appear, which Indian Hills has done. OPC also criticizes Indian Hills for keeping inadequate records, but the improvement in Indian Hills' recordkeeping is undisputed. OPC criticizes Indian Hills for how Indian Hills prioritized its improvements to the system and doing repairs instead of replacements, but reasonable minds may disagree as to which action was prudent under the facts known at the time. Moreover, OPC cites no authority under which the quality of management influences the account under which Indian Hills must record an expense.

¹⁸⁸ Section 393.140(4).

¹⁸⁹ 4 CSR 240-50.030(1).

¹⁹⁰ EFIS No. 127 (December 7, 2017) *Exhibit No. 114 - USoA Operating Expense Instructions*, second page.

OPC also cites USoA Account 343 Transmission and Distribution Mains. But that provision states that adding a minor and insubstantial item of property constitutes a maintenance expense:

When a minor item of property which did not previously exist is added to plant, the cost thereof shall be accounted for in the same manner as for the addition of a retirement unit, as set forth in paragraph B (I), above, if a substantial addition results, otherwise the charge shall be to the appropriate maintenance expense account. [¹⁹¹]

That language describes adding a section of pipe, which is how Indian Hills repairs its lines, so that language reinforces Staff's argument that repairs constitute a maintenance expense.

As to future repair expenses, Indian Hills and Staff seeks to establish a repair expense tracker as follows.

Repair Expense Tracker: The signatories agree to a two-way tracker for repair expenses related to water main repair and service line repair expense, with a \$90,000 base amount.¹⁹²

In its brief, OPC objects to this position, arguing that the tracker is not on the issues list and is not the subject of any pre-filed testimony. OPC did not object to testimony on the tracker at the evidentiary hearing.¹⁹³ On the contrary, OPC actively cross-examined several witnesses on that subject. Because the Commission received evidence on the tracker without objection, and because that evidence has probative value as to just and

¹⁹¹ EFIS No. 128 (December 7, 2017) *Exhibit No. 115 - Utility Plant Instructions*, second page.

¹⁹² EFIS No. 87 (November 22, 2017) *Non-Unanimous Stipulation and Agreement* page 5 paragraph 8. Emphasis in original.

¹⁹³ Commission regulation 4 CSR 240-2.130(7)(A) requires that "[d]irect testimony shall include all testimony and exhibits asserting and explaining that party's entire case-in-chief." Under that regulation, the Commission denied a tracker in **Hillcrest Rate Case**. But, in that case, the applicant raised that position for the first time in its post-hearing brief. File No. WR-2016-0064, EFIS No. 93 (July 12, 2016) *Report and Order*, page 18 through page 19.

reasonable rates for safe and adequate service, the Commission must consider that evidence along with the other evidence.¹⁹⁴

As the findings show, deferred recording will not involve any USoA account not ordinarily used in setting water rates. And, even if it did, the record shows good cause for a variance from USoA on this point.¹⁹⁵ The parties dispute sharply whether the cost of fixing leaks will rise or fall, and such uncertainty supports the use of a tracker. Indian Hills' history of frequent breakdowns, repairs, and replacements in the past supports a projection of frequent breakdowns, repairs, and replacements in the future. Comparing the expense in future years to the amount currently in rates will be helpful in its next small public utility rate case.

Nevertheless, the Commission expressly states that ordering the repair expense tracker does not constitute a pre-judgment as to any amounts to include in future rates. Moreover, ordering the repair expense tracker does not constitute a prejudgment as to whether any repair is more prudent than any replacement. With those caveats in place, on the issue of repair expenses and a tracker, the Commission will order the filing of compliance tariffs according to Indian Hills and Staff.

Also, Indian Hills and Staff ask for an order directing the filing of monthly usage data as follows.

On a quarterly basis, Indian Hills will submit to the Staff Water and Sewer Department monthly usage data, inclusive of water loss.¹⁹⁶

¹⁹⁴ Section 536.070(8).

¹⁹⁵ 4 CSR 240-2.060(4).

¹⁹⁶ EFIS No. 87 (November 22, 2017) *Non-Unanimous Stipulation and Agreement* page 6 paragraph 13.

Such a provision will supply data for the future. OPC offers no evidence or argument to the contrary. The Commission will order that the monthly usage data include both water lost and water billed, and will order the data submitted to OPC at the same time as Indian Hills submits it to Staff.

Further, Indian Hills and Staff ask for an order directing a study of the system and a plan for improvements. And, in their brief, Indian Hills asks for even more detailed reporting instructions:

Indian Hills agrees to develop a five-year Distribution System Improvement Plan (DSIP) for replacement of mains and service connections, where such replacement is necessary and prudent. The goal of the DSIP will be to continue current efforts to reduce the frequency of significant leaks and water loss, and provide a predictable construction schedule for its customers. To develop the DSIP, Indian Hills will perform an engineering study to outline the water system areas based on historical repair data and current distribution line plans that should be scheduled for main replacement, and submit the DSIP to OPC and the PSC Water and Sewer Department by April 15, 2018. The DSIP will include the engineering study and the five-year schedule proposal to address the most problematic portions of the system. Thereafter, Indian Hills shall submit progress reports as to the replacement program developed in the DSIP with its annual reports. The progress reports will update the DSIP, with explanations of any adjustments to the five-year schedule. The progress reports will continue for a five year period (until April 15, 2023), unless sooner modified by Commission order.

That language better describes the study.

With those further provisions, on the issue of leak repair expense including the new positions, the Commission will order relief as sought by Indian Hills and Staff.

vii. *Extension of Electrical Service*

The Commission is ordering that Indian Hills' compliance tariffs shall include amounts in rates and charges for the electrical extension as argued by OPC, and as argued in the alternative by Staff. The issues list and the prevailing position statement use the following language.

a. *Should the Company be able to capitalize the electric line extension?*

- *The Company does not own the electric line extension. For this reason, no party should recommend that it be capitalized. This is OPC's position, which is consistent with NARUC USOA, Account 101.*

b. *If so, what are the appropriate accounts to book the extension of electric line service?*

- *Again, the Company does not own the electric line extension. This question [of capitalization] should be moot for all parties.*

Findings of Fact

1. Indian Hills' system uses industrial electrical and pumping equipment for a new well, booster pumps, ground storage and well house¹⁹⁷ ("the equipment") that required a three-phase power connection.¹⁹⁸

2. To serve the three-phase power connection, Crawford Electrical Cooperative ("the Cooperative") required Indian Hills to pay "a non-refundable payment in the sum of \$23,000" for the cost of facilities (electrical extension") required to make service available to [Indian Hills for the equipment] on or before commencement of construction of such facilities."¹⁹⁹

¹⁹⁷ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 4 line 4, through line 7.

¹⁹⁸ EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 15 line 16, through 21.

¹⁹⁹ EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 16 line 8, through 11.

3. The alternative to the three-phase power connection was a “phase-a-matic converter.”²⁰⁰ A phase-a-matic converter is more expensive, less reliable, and more susceptible to power surges.²⁰¹ A phase-a-matic converter lowers equipment life spans, increases operations and maintenance costs, and results in higher customer rates.²⁰² The electrical extension was a practical necessity for the equipment and any other new plant requiring electricity.²⁰³

4. Indian Hills made that payment to the Cooperative on May 17, 2016.²⁰⁴ The Cooperative constructed the electrical extension. The Cooperative owns the electrical extension.²⁰⁵

5. Indian Hills does not own the electrical extension.²⁰⁶

Discussion

OPC argues that, because Indian Hills does not own the electrical extension, Indian Hills must treat the cost as an expense, not capital, and recommends amortizing it over five years. In support, OPC cites USoA Account 101 Utility Plant in Service.²⁰⁷

²⁰⁰ EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 16 line 15, through 18.

²⁰¹ EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 16 line 18, through 21.

²⁰² EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 16 line 18, through 21.

²⁰³ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 363 line 23 through line 25.

²⁰⁴ EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 16 line 12, through line 14.

²⁰⁵ EFIS No. 135 (December 7, 2017) *Exhibit No. 207 - Surrebuttal Testimony of John A. Robinett* Schedule JAR-S-1 Affidavit of Brett Palmer, Manager of Operations with Crawford Electric Cooperative, Inc.

²⁰⁶ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 362 line 3, through line 5.

²⁰⁷ Incorporated into the Commission’s regulation 4 CSR 240 - 50.030(1) pursuant to the authority at Section 393.140(4).

A. This account shall include the original cost of utility plant, included in the plant accounts prescribed herein and in similar accounts for other utility departments, owned and used by the utility in its utility operations, and having an expectation of life in service of more than one year from date of installation, including such property owned by the utility but held by nominees. Separate subaccounts shall be maintained hereunder for each utility department.”²⁰⁸

That language shall “be observed by . . . water corporations [.]²⁰⁹”

Account 101’s plain language requires ownership for capitalization. Account 101 extends capital treatment to things possessed by another entity, but not to things owned by another entity, and bases capitalization squarely on ownership. Ownership of the electrical extension is in the Cooperative. Indian Hills does not own the electrical extension. As OPC argues, “The Company has no right to earn a return on the electric plant of another utility [.]²¹⁰”

In favor of capitalizing the electrical extension, Indian Hills and Staff cite USoA Account 325, Electrical Pumping Equipment:

[T]his account shall include the cost installed of pumping equipment driven by electric power . . .

* * *

6. Electric power lines and switching. [²¹¹]

None of those words in Account 325 negates Account 101’s basic requirement of ownership. Indian Hills also offered expert testimony that any utility may capitalize

²⁰⁸ EFIS No. 134 (December 7, 2017) *Exhibit No. 206 - Rebuttal Testimony of John A. Robinett* page 2 line 16, through line 25 (emphasis OPC’s).

²⁰⁹ Section 393.140(4).

²¹⁰ EFIS No. 176 (January 4, 2018) *Brief of the Office of the Public Counsel* page 32.

²¹¹ EFIS No. 98 (December 7, 2017) *Exhibit No. 5 - Rebuttal Testimony of Phil Macias (Public & Confidential)* page 4 line 15.

anything remotely connected with the operation of a capital item.²¹² Indian Hills cites no authority supporting that argument, and its testimony on that issue is unpersuasive. Indian Hills alleges that the three-phase power connection was a practical necessity, which OPC does not dispute, and the Commission has found.

Also, Staff cites an earlier decision in which the Commission ordered the capitalization of a cost for inspection fees.²¹³ The earlier decision's analysis is unpersuasive. The earlier decision cites no authority for treating something that a utility does not own as a capital asset.

In the alternative, Staff supports OPC's position,²¹⁴ which the Commission concludes is correct under the law, that the electrical extension constitutes an expense. The electrical extension represents a one-time payment for the construction of Cooperative property to serve Indian Hills. The Commission will order the compliance tariffs to amortize the amount over five years. The Commission bases that ruling on the experience, knowledge, and training of expert witnesses²¹⁵ and not, as Indian Hills argues, on a mistaken reading of the contract with the Cooperative.²¹⁶

The Commission concludes that the electrical extension constitutes an expense, and not a capital item. Therefore, on the issue of the electrical extension, the

²¹² EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 362 line 24, through page 364 line 25.

²¹³ Case No. ER-90-101, *Report and Order* (October 5, 1990) page 33 through 34, ***In the matter of Missouri Public Service for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company, at al.***

²¹⁴ EFIS No. 120 (December 7, 2017) *Exhibit No. 108 - Rebuttal Testimony of Jennifer K. Grisham* (Public & Confidential) page 4 line 16, through 18.

²¹⁵ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 388 line 23, through page 390 line 23. EFIS No. 120 (December 7, 2017) *Exhibit No. 108 - Rebuttal Testimony of Jennifer K. Grisham* (Public & Confidential) page 4 line 16, through 18.

²¹⁶ EFIS No. 101 (December 7, 2017) *Exhibit No. 8 - Rebuttal Testimony of Todd Thomas* page 16 line 3, through line 11.

Commission will order the filing of compliance tariffs according to the OPC position statement and Staff’s alternative position.

B. Rate of Return²¹⁷

The Commission is ordering that Indian Hills’ compliance tariffs shall include amounts in rates and charges for a:

- a. Debt to equity ratio of 50/50 as sought by OPC,
- b. Cost of debt at 6.75 percent as sought by OPC, and
- c. Return on equity at 12 percent as sought by Indian Hills and Staff.

The resulting rate of return is 9.375 percent.

Findings of Fact

1. Standard financial practice measures the return on an investment by multiplying the cost of each capital component (debt and equity) by its respective proportion in the capital structure, and adding the two products together, yielding a weighted average cost of capital, (“WACC”) which equals the rate of return.²¹⁸

100% Capitalization	=	Debt %	x Return on Debt	= Cost of Debt	=	Weighted Cost of Capital (Rate of Return)
		Equity %	x Return on Equity	= Cost of Equity		

2. As the table above shows, capital structure is the proportion of debt to equity that finances an enterprise. Whatever the returns on debt and equity, the proportions of

²¹⁷ The Commission addresses this issue out of the sequence set forth in the issues list for a more logical progression in the construction of a rate. The issues list numbers the issues as VIII Rate Design and IX. Rate of Return. But rate of return is part of the revenue requirement that Indian Hills must collect, and rate design is how Indian Hills will collect the revenue requirement, so the Commission addresses those issues in that order.

²¹⁸ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D’Ascendis* page 3, line 1, Table 1.

debt and equity constitute the multiplier for each. For that reason, capital structure is crucial in determining a rate of return.

3. Determining values for the variables in the WACC formula may include using a proxy. A proxy is an entity that is similar in significant characteristics. Public utilities may be significantly similar for WACC while appearing significantly different otherwise; for example, public utilities that vary greatly in size may constitute valid proxies because their financial strength is the same.²¹⁹

4. When it comes time for payment to lenders and investors, or collection, debt has priority over equity; so equity must compensate for debt's priority by offering a higher rate.²²⁰

Discussion

Indian Hills' returns depend on the Commission's rulings on values related to capital components. Those rulings are as follows.

100% Capitalization	=	50% debt	x 6.75%	= 3.375%	=	9.375% Rate of Return
		50% equity	x 12.00%	= 6.000%		

The grounds for those rulings are as follows.

i. Capital Structure.

The issues list and the prevailing position statement use the following language.

a. What capital structure should be used for determining rate of return?

- *[A] 50-50 capital structure to reflect what the Company should be working toward, over time, in order to improve its financial standing. Currently, the*

²¹⁹ EFIS No. 95 (December 7, 2017) *Exhibit No. 2 - Rebuttal Testimony of Josiah Cox (Public & Confidential)* page 17 line 1, through 12; EFIS No. 103 *Exhibit 10, Direct Testimony of Dylan W. D'Ascendis*, Schedule DWD-3 page 1 of 9, and Schedule DWD-4 page 2 of 12.

²²⁰ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D'Ascendis* 19 line 5, through line 20.

utility is highly leveraged with debt, which arguably could have impacted its ability to obtain a lower cost of debt on the market.

Findings of Fact

1. The contributions of both customers and the public utility act like a partnership in support of safe and adequate service.²²¹ Just and reasonable rates recognize the public utility investments that benefit customers by providing, not only a fair rate of return, but also the ability to build up balance sheet strength and create some financial standing and integrity that allow the public utility to borrow funds under less restrictive conditions, particularly with arm's-length transactions with lenders.²²²

2. Sound ratemaking practice accomplishes those goals by using a hypothetical capital structure under which a public utility can retain earnings to grow the invested capital by reinvestment in plant, and to pay down more expensive borrowing sources.²²³ Reinvestment and paying down debt will produce an actual capital structure of common equity and debt in a ratio representative of a stronger business entity.²²⁴ For a system with no history of reinvestment, like Indian Hills' system, a hypothetical capital structure may result in safer and more adequate service at rates that give the public utility the opportunity for greater financial strength.²²⁵

²²¹ EFIS No. 93 (December 5, 2017) *Transcript - Volume 6 (Evidentiary Hearing 11-30-17)* page 553 line 19, through line 22.

²²² EFIS No. 93 (December 5, 2017) *Transcript - Volume 6 (Evidentiary Hearing 11-30-17)* page 553 line 22, through page 554 line 7.

²²³ EFIS No. 93 (December 5, 2017) *Transcript-Volume 6 (Evidentiary Hearing 11-30-17)* page 554 line 8, through line 22.

²²⁴ EFIS No. 93 (December 5, 2017) *Transcript-Volume 6 (Evidentiary Hearing 11-30-17)* page 554 line 23, through page 555 line 4.

²²⁵ EFIS No. 93 (December 5, 2017) *Transcript-Volume 6 (Evidentiary Hearing 11-30-17)* page 555 line 23, through page 556 line 7.

3. A 50/50 hypothetical capital structure is appropriate for supporting a public water utility in the state of Missouri.²²⁶ That is because keeping debt at 50 percent or below discourages excessive debt that unduly burden customers,²²⁷ and keeping equity at 50 percent or above discourages excessive equity costs.²²⁸ In these circumstances, a public utility should have no more than 50 percent debt and no less than 50 percent equity.²²⁹

4. A 50/50 ratio of debt to equity thus reflects the goals of safe and adequate service at just and reasonable rates because it may result in safer and more adequate service at rates that give the public utility the opportunity for greater financial strength.²³⁰

5. Indian Hills does not issue stock for public trade, so its actual capital structure is uncertain,²³¹ and a hypothetical capital structure is more certain to support safe and adequate service at just and reasonable rates.²³² For Indian Hills, a 50/50 hypothetical capital structure will direct Indian Hills toward capital re-investment and repayment of

²²⁶ EFIS No. 172 (December 11, 2017) *Exhibit No. 213 - Surrebuttal Testimony of Michael P. Gorman* page 4 line 21, through page 5 line 3.

²²⁷ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 3 line 21, through line 23.

²²⁸ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 3 line 21, through line 23.

²²⁹ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 3 line 8, through line 10.

²³⁰ EFIS No. 93 (December 5, 2017) *Transcript-Volume 6 (Evidentiary Hearing 11-30-17)* page 555 line 23, through page 556 line 7.

²³¹ Just how uncertain Indian Hills' capital structure is appears in the testimony of Indian Hills and OPC. Indian Hills claims to have an actual capital structure 77.12% debt and 22.88% equity. EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D'Ascendis* page 3 line 1, Table 1. OPC alleges that Indian Hills' actual capital structure has but a fraction of that equity. EFIS No. 170 (December 11, 2017) *Exhibit No. 214 - Rebuttal Testimony of Michael P. Gorman (Confidential)* page 3 line 8, through line 11.

²³² EFIS No. 93 (December 5, 2017) *Transcript - Volume 6 (Evidentiary Hearing 11-30-17)* page 545 line 2, through line 8.

high-interest debt, which will result in financial health²³³ and access to outside capital.²³⁴ Those results favor both the utility and the customers.

Discussion

Indian Hills and Staff argue that the Commission should order that the compliance tariffs include amounts for rates and charges based on a capital structure of 78.8 percent debt and 21.2 percent equity because that is Indian Hills' actual capital structure. Assuming, without deciding, that 78.8/21.2 represents Indian Hills' actual capital structure, the Commission concludes that a 50/50 hypothetical capital structure better supports safe and adequate service at just and reasonable rates. OPC's evidence showed that a 50/50 capital structure provides financial strength that better balances the interests of Indian Hills and its customers by protecting the customers from unduly burdensome debt and capital expenses while strengthening Indian Hills' finances.²³⁵

Indian Hills argues that Indian Hills cannot have a 50/50 capital structure because Indian Hills cannot obtain conventional financing. But one of the advantages to a 50/50 capital structure is that it will help Indian Hills find outside capital.²³⁶ Further, the Commission directed Indian Hills to use the financing authorized in the acquisition case

²³³ EFIS No. 93 (December 5, 2017) *Transcript-Volume 6 (Evidentiary Hearing 11-30-17)* page 553 line 23, through 555 line 3. EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 3 line 24, through page 4 line 2.

²³⁴ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 3 line 20, through line 21.

²³⁵ EFIS No. 172 (December 11, 2017) *Exhibit No. 213 - Surrebuttal Testimony of Michael P. Gorman* page 4 line 21, through page 5 line 3.

²³⁶ Indian Hills also cites **Hillcrest Rate Case**, in which the Commission used an actual capital structure, but offers no authority requiring the Commission to reach a similar result on a different record.

solely to acquire and improve the system. Indian Hills violated that directive.²³⁷ A 50/50 capital structure will encourage financial integrity, which the Commission intended in the acquisition case, for the benefit of the system in which Indian Hills and the customers share an interest. The Commission encourages Indian Hills to seek outside financing before its next rate case.

Therefore, on the issue of capital structure, the Commission will order the filing of compliance tariffs according to the OPC position statement.

ii. Cost of Debt.

The issues list and the prevailing position statement use the following language.

b. What cost of debt should be used for determining rate of return?

- *OPC recommends 6.75% as a reasonable imputed cost of debt [.] Mr. Gorman and Mr. Meyer explain why the Company's financing agreement has not been shown to be prudent. The financing agreement involves affiliate relationships raising the risk of self-dealing; and furthermore, the financing agreement contains a high interest rate and prevents refinancing. These conditions are not beneficial to ratepayers, and it would be unreasonable to pass forward these costs to ratepayers.*

Findings of Fact

1. Indian Hills' cost of debt is significantly above market cost of debt for a distressed public utility.²³⁸ Indian Hills' cost of debt is the result of dealings among entities closely inter-related with Indian Hills through chains of common ownership on both sides of the transaction as follows.

²³⁷ EFIS No. 204 *Surrebuttal Testimony of Keri Roth (Public)* page 2 line 12, through line 18. File No. WO-2016-0045, EFIS No. 14 (February 3, 2016) *Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity* page 9 paragraph 21, ***In the Matter of the Application of Indian Hills Utility Operating Company, Inc. to Acquire Certain Water Assets of I. H. Utilities, Inc. and, in Connection Therewith, Issue Indebtedness and Encumber Assets.***

²³⁸ EFIS No. 93 (December 5, 2017) *Transcript - Volume 6 (Evidentiary Hearing 11-30-17)* page 552 line 19, through line 23.

Lender and Borrower²³⁹

2. Robert Glarner, Jr. and David Glarner (“the Glarners”) own GWSD, LLC.²⁴⁰
3. GWSD, LLC, owns:
 - a. 87 percent of First Round CSWR, LLC;²⁴¹ and
 - b. A minority percentage of Central States Water Resources, Inc.,²⁴² which manages First Round CSWR, Inc.²⁴³
4. First Round CSWR, LLC:
 - a. Manages Indian Hills; and
 - b. Owns Indian Hills Utility Holding Company, Inc., which owns Indian Hills.²⁴⁴
5. Indian Hills borrowed \$1.45 million²⁴⁵ from Fresh Start Venture, LLC (“the loan”).²⁴⁶

²³⁹ EFIS No. 136 (December 7, 2017) *Exhibit No. 208 - Direct Testimony of Greg R. Meyer (Confidential)* page 3 line 1, through page 4 line 9; and Confidential Schedule GRM-1.

²⁴⁰ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 420 line 1, through line 2.

²⁴¹ The remaining 13 percent of First Round CSWR, LLC belongs to Josiah Cox. EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 419 line 17, through line 25.

²⁴² EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 423 line 13, through line 19. The majority owner of Central States Water Resources, Inc. is Josiah Cox. EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 419 line 1, through line 4.

²⁴³ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 422 line 23, through page 423 line 2.

²⁴⁴ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 423 line 13, through line 19.

²⁴⁵ EFIS 103 *Exhibit No. 10 Direct Testimony of Dylan W. D’Ascendis* page 39 line 8.

²⁴⁶ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 412 line 11, through line 13.

6. Fresh Start Venture, LLC is funded, and is indirectly controlled,²⁴⁷ by the Glarners.²⁴⁸

7. Josiah Cox, Robert Glarner, Jr., and David Glarner, constitute the officers and board of directors for Central States Water Resources, Inc.,²⁴⁹ Indian Hills Utility Holding Company, Inc.,²⁵⁰ and Indian Hills.²⁵¹

8. When Josiah Cox inquired into financing for Indian Hills, he did not offer to secure any financing with the personal guarantee of himself, Robert Glarner, Jr., or David Glarner.²⁵²

Other Small Water Companies in Missouri

9. For the five years before October 13, 2016, 25 small water companies, applied for new rates from the Commission, including Hillcrest.²⁵³

10. Almost all of those companies had debt outstanding, some had environmental issues, and some secured their debt with assets other than their system including personal guarantees of the owners.²⁵⁴

²⁴⁷ The Glarners also own Water Fund LLC. EFIS No. 157 (December 7, 2017) *Exhibit No. 233 - Articles of Incorporation, Water Fund, LLC.*

²⁴⁸ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 420, line 1, through line 10; page 457 line 22, through page 458 line 1.

²⁴⁹ EFIS No. 161 (December 7, 2017) *Exhibit No. 237 - 2017 Annual Registration Report Central States Water Resources, Inc.*

²⁵⁰ EFIS No. 154 (December 7, 2017) *Exhibit No. 230-2017 Annual Registration Form, Indian Hills Utility Holding Company, Inc.*

²⁵¹ EFIS No. 149 (December 7, 2017) *Exhibit No. 225 - 2017 Annual Registration Report, Indian Hills Utility Operating Company, Inc.*

²⁵² EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 425 line 9, through page 426 line 6.

²⁵³ EFIS No. 139 (December 7, 2017) *Exhibit No. 211 - Surrebuttal Testimony of Greg R. Meyer (Public)* page 6 line 16, through page 7 line 6; Schedule GRM-SUR-2. EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 487 line 18 through 20.

11. The average interest rate paid by those companies, other than Hillcrest, was 5.16 percent.²⁵⁵

The Loan

12. The loan includes the following provisions.

- a. Interest at 14 percent.²⁵⁶
- b. A term of 20 years.²⁵⁷
- c. A pre-payment penalty.²⁵⁸

13. Pre-payment penalties are not unusual, but a pre-payment penalty combined with 14 percent interest is unusual, even for a distressed small water company.²⁵⁹

14. Moreover, the loan's penalty accelerates all 20 years' interest and makes it due if Indian Hills pays off the loan early, as in refinancing.²⁶⁰ Refinancing under the pre-payment penalty is therefore of benefit only to the lender.²⁶¹

²⁵⁴ EFIS No. 108 (December 7, 2017) *Exhibit No. 15 - Indian Hills Utility Operating Company, Inc., Small Water and Sewer Utility Debt Costs, Table of Financing*. EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 472 line 15, through 477 line 4.

²⁵⁵ EFIS No. 139 (December 7, 2017) *Exhibit No. 211 - Surrebuttal Testimony of Greg R. Meyer (Public)* page 6 line 16, through page 7 line 6; Schedule GRM-SUR-2. EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 487 line 18 through 20.

²⁵⁶ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 490 line 19 through line 20.

²⁵⁷ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 492, line 6, through line 7.

²⁵⁸ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 490, line 19, through line 23.

²⁵⁹ EFIS No. 93 (December 5, 2017) *Transcript - Volume 6 (Evidentiary Hearing 11-30-17)* page 552 line 3, through 553 line 13.

²⁶⁰ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 490, line 24, through page 491 line 4.

²⁶¹ EFIS No. 136 (December 7, 2017) *Exhibit No. 208 - Direct Testimony of Greg R. Meyer (Confidential)* page 14 line 1, through line 23.

15. The pre-payment penalties among all systems that First Round CSWR, LLC manages in Missouri aggregate to approximately \$15 million.²⁶²

Market Rate

16. A public utility should pay to its lenders, and pass along to its customers in rates and charges, the market price for the public utility's debt.²⁶³

17. Because debt has priority over equity, equity must compensate with a better return than debt. Therefore, when return on equity is at 12 percent, debt at 14 percent must be above the market rate.²⁶⁴ An interest rate of 14 percent is significantly above the market rate.²⁶⁵

18. The market price of an entity that has not taken its debt to market is discernible as a hypothetical by comparing the observable market debt of a similarly situated entity—a proxy.²⁶⁶

19. Services like S&P or Moody's grade the quality of investments.²⁶⁷ The cost of debt for an investment rate utility company is about 4.0%.²⁶⁸ A small distressed utility

²⁶² EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 491 line 11, through line 16.

²⁶³ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 5 line 4, through line 8.

²⁶⁴ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D'Ascendis* page 19 line 5 through line 20; and EFIS No. 93 (December 5, 2017) *Transcript-Volume 6 (Evidentiary Hearing 11-30-17)* page 563 line 3, through page 564 line 4.

²⁶⁵ EFIS No. 93 (December 5, 2017) *Transcript - Volume 6 (Evidentiary Hearing 11-30-17)* page 552 line 19, through line 23.

²⁶⁶ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 5 line 4, through line 8.

²⁶⁷ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 4 line 20, through line 21.

²⁶⁸ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 5 line 2, through line 4.

like Indian Hills does not have a rating from S&P and Moody's²⁶⁹ but distressed utilities generally do, and the rating is "below investment grade" for distressed utilities.²⁷⁰ Therefore, the debt issuances of a below investment grade utility reflect the cost of debt for a distressed utility.²⁷¹

20. In the last few years,²⁷² only one below investment grade utility issued bonds.²⁷³ That utility issued bonds at 6.41 percent to 7.25 percent with a median of 6.75 percent.²⁷⁴ Applying an indexed bond yield to the actual proxy rates of 6.41 percent to 7.25 percent also results in 6.75 percent.²⁷⁵ That shows that a lower rate is available with an independent lender, and that the market rate for a utility comparable to Indian Hills, in arm's length dealing, is 6.75 percent.²⁷⁶

Discussion

Indian Hills and Staff ask the Commission to order that the compliance tariffs set rates and charges to include amounts to service the loan. OPC alleges that the loan's

²⁶⁹ EFIS No. 107 (December 7, 2017) *Exhibit No. 14 - Rebuttal Testimony of Michael E. Thaman, Sr.* page 3 line 20, through line 23.

²⁷⁰ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 4 line 22, through page 5 line 2.

²⁷¹ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 4 line 22, through page 5 line 2.

²⁷² EFIS No. 172 (December 11, 2017) *Exhibit No. 216 - Surrebuttal Testimony of Michael P. Gorman* page 10, through line 13.

²⁷³ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 4 line 13, through line 21.

²⁷⁴ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 4 line 15, through line 20; Schedule MPG-3.

²⁷⁵ EFIS No. 172 (December 11, 2017) *Exhibit No. 216 - Surrebuttal Testimony of Michael P. Gorman* page 12, through line 20.

²⁷⁶ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 4 line 13, through page 5 line 8.

provisions are unjust and unreasonable as to the customers. OPC asks that the Commission order the tariffs to collect only those amounts that loan would require if Indian Hills procured the loan through an arm's length transaction in the marketplace.

The weight of the evidence favors OPC. OPC has shown that the loan's provisions include costs far above what Indian Hills must pay. The loan does not resemble an arm's-length transaction because the Glarners are behind each end of the transaction. The Commission understands the legal status of business organizations as legal persons. The Commission cannot ignore financial reality.

A loan constitutes a circuit that conducts money. The money starts with the lender, passes through the borrower's business for profit, and returns with interest to the lender. Lenders and borrowers may lend to and borrow from whomever they choose, on whatever terms they choose, as the law allows. However, the loan before the Commission is different from other lending transactions, even for a wholly-owned subsidiary, which must borrow money from whomever and under whatever provisions its owner says.

The difference with the Indian Hills loan is that Indian Hills' business for profit is a State-granted monopoly. The Commission has exclusively certified Indian Hills to provide water to captive customers.²⁷⁷ Those customers cannot, as ordinary retail customers do, go to elsewhere to serve their residences with water. Those facts bring

²⁷⁷ File No. WO-2016-0045, EFIS No. 14 (February 3, 2016) *Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity Commission* page 6, paragraph 1. ***In the Matter of the Application of Indian Hills Utility Operating Company, Inc. to Acquire Certain Water Assets of I. H. Utilities, Inc. and, in Connection Therewith, Issue Indebtedness and Encumber Assets.***

the loan within one of the Commission's primary functions—to substitute reasonable regulation for the missing marketplace.²⁷⁸

The marketplace does not produce 14 percent interest and a 20-year pre-payment penalty—or even a ten-year pre-payment penalty—so far as the record shows. Therefore, the Commission must determine a marketplace interest rate for the loan based on the record.

Indian Hills relies heavily on the absence of any source of lower interest. But OPC has shown that a below-investment grade utility may issue debt for 6.75 percent. Indian Hills criticizes that analysis for dissimilarities between Indian Hills and OPC's proxy, mainly based on scale. That argument might have some resonance if Indian Hills' proxies did not include large utilities²⁷⁹ among which are the largest utilities in Missouri.²⁸⁰ And while Indian Hills' approach to equity considers the size of a public utility, Indian Hills has not shown that greater scale in operations results in fewer challenges to a distressed utility's operation or a greater ability to attract debt at lower rates.

Indian Hills' Exhibit 15 discusses²⁸¹ the other small water companies listed in Schedule GRM-SUR-2.²⁸² Schedule GRM-SUR-2 comes from the small public utility

²⁷⁸ EFIS No. 93 (December 5, 2017) *Transcript - Volume 6 (Evidentiary Hearing 11 - 30 - 17)* page 558 line 2, through 18.

²⁷⁹ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. W. D'Ascendis* Schedule DWD-3, page 1 of 9, and Schedule DWD-4 page 2 of 12;

²⁸⁰ EFIS No. 95 (December 7, 2017) *Exhibit No. 2 - Rebuttal Testimony of Josiah Cox (Public & Confidential)* page 17 line 1, through line 12. EFIS No. 104 (December 7, 2017) *Exhibit No. 11 - Rebuttal Testimony of Dylan W. D'Ascendis* page 9 line 1, through line 8. EFIS No. 105 (December 7, 2017) *Exhibit No. 12 - Surrebuttal Testimony of Dylan W. D'Ascendis* page 4 line 5, through line 12.

²⁸¹ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 472 line 15, through line 25.

rate case filed by another Glarners' entity.²⁸³ Schedule GRM-SUR-2 showed that such sources were available to 24 other small water companies in Missouri. No party challenges the accuracy of any cost of debt set forth in Schedule GRM-SUR-2. The average of those costs of debt, excluding Hillcrest, is 5.16 percent. That cost of debt is close to Staff's original recommendation.²⁸⁴ Instead, Indian Hills seeks to distinguish itself from the small water companies listed in Schedule GRM-SUR-2.

But Indian Hills' distinguishing evidence is second-hand,²⁸⁵ so Exhibit 15 inevitably carries the vagaries of second-hand evidence.²⁸⁶ The absent declarants were not subject to cross-examination by the parties or the Commission, so the accuracy of the declarants' perceptions and representations is untested. Even conceding 100 percent candor and accuracy to Indian Hills' witness on this point does not increase the weight of Indian Hills' evidence on this point to match the plain content of Schedule GRM-SUR-2. Indian Hills has never challenged the accuracy of Schedule GRM-SUR2.

Even if the Commission gave full weight to Indian Hills' evidence on this point, the Commission would remain unconvinced.

²⁸² EFIS No. 139 (December 7, 2017) *Exhibit No. 211 - Surrebuttal Testimony of Greg R. Meyer (Public)* page 6 line 16, through page 7 line 6; Schedule GRM-SUR-2. EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 487 line 18 through 20.

²⁸³ File No. SR-2016-0202, EFIS No. 30, (October 13, 2016) *Rebuttal Testimony of Charles R. Hyneman* Schedule CRH R-1; page 12 line 17, through line 24. ***In the Matter of the Application of a Rate Increase for Raccoon Creek Utility Operating Company Inc.***

²⁸⁴ EFIS No. 90 (December 5, 2017) *Transcript - Volume 3 (Evidentiary Hearing 11-27-17)* page 181 line 14, through line 18.

²⁸⁵ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 469 line 3, through line 4; page 470 line 17, through line 20; page 473, line 3, through line 7.

²⁸⁶ OPC objected to Exhibit 15, summarizing Indian Hills' evidence on this point. The Commission overruled that objection under Section 536.070(11), which provides that "All the circumstances relating to the making of such . . . survey . . . may be shown to affect the weight of such evidence but such showing shall not affect its admissibility [.]" EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11-28-17)* page 477 line 5, through page 478 line 10.

Indian Hills argues that the lower interest rates of other small utilities are due to undesirable characteristics that Indian Hills does not have. For example, Indian Hills argues that some of the small utilities still have environmental issues that make their business risky. That logic does not aid Indian Hills because Indian Hills has, commendably, remedied its environmental violations. Indian Hills' improved condition should, under Indian Hills' logic, make lower interest available to Indian Hills.

Indian Hills also argues that some of the small utilities have additional collateral securing the loans—personal assets of the owners. That argument also works against Indian Hills because whether to offer such additional security is the investors' choice, and the customers need not pay the extra interest occasioned by that choice.

Indian Hills argues that Staff determined that the system had a net book value of only \$43,966 at the time of the acquisition case.²⁸⁷ The acquisition case contains no Commission determination of the system's net book value, and the parties to the sale of Indian Hills' purchase valued the system at substantially more.²⁸⁸ Moreover, Indian Hills does not show that its net book value distinguishes its cost of debt from the other small utilities.

Indian Hills also cites **Hillcrest Rate Case**, in which the Commission approved a 14% interest rate.²⁸⁹ The Commission prefers to be consistent in its analysis and follow

²⁸⁷ EFIS No. 95 (December 7, 2017) *Exhibit No. 2 - Rebuttal Testimony of Josiah Cox (Public & Confidential)* page 4 line 21, through line 22.

²⁸⁸ File No. WO-2016-0045, EFIS No. 1, *Application and, If Necessary, Motion for Waiver* Appendix E (Highly Confidential), ***In the Matter of the Application of Indian Hills Utility Operating Company, Inc. to Acquire Certain Water Assets of I. H. Utilities, Inc. and, in Connection Therewith, Issue Indebtedness and Encumber Assets.***

²⁸⁹ **Hillcrest Rate Case** seems to be the strongest basis for Staff's lukewarm endorsement of 14 percent interest. EFIS No. 90 (December 5, 2017) *Transcript-Volume 3 (Evidentiary Hearing 11-27-17)* page 177 line 19, through line 24; page 181 line 2, through line 10. Indeed, Staff initially recommended five percent

its earlier decisions but will depart from earlier decisions when there is good reason. Here, there is good reason. **Hillcrest Rate Case** was the first rate case for of the Glarner entities. With a growing number of systems, and more experience in operations and regulatory practice, market prices for credit should follow. In this case, the record convinces the Commission that the interest rate and pre-payment penalty exceed what the marketplace offers, that the excess constitutes a benefit to the Glarners only, and not the ratepayers, and it would be unreasonable to pass forward these costs to ratepayers.

The premise underlying all Indian Hills' arguments about the loan is that it tried to get better financing but none was available. Indian Hills and Staff defy OPC to find a lender at market rates but that argument reverses the burden of proof; OPC has no duty to find Indian Hills a lender. Indian Hills has the burden of proof to show that its rate increase supports just and reasonable rates.²⁹⁰ The documentation of Indian Hills' search for debt is scant and, in some cases, irrelevant.²⁹¹ The Commission finds it unconvincing.

Moreover, even if other Glarners' entities were Indian Hills' only possible source of capital, that limitation would not necessitate the loan's provisions. The Glarners' entities have routinely transferred equity among one another.²⁹² The loan's high interest

interest. EFIS No. 174 (December 11, 2017) *Exhibit No. 245 - Recommended Rate of Return for Indian Hills Utility Operating Company, Inc. as of March 31, 2017*. The staff member making that recommendation participated no further in the case. EFIS No. 90 (December 5, 2017) *Transcript-Volume 3 (Evidentiary Hearing 11-27-17)* page 176 line 23, through page 177 line 10.

²⁹⁰ Section 393.150.2.

²⁹¹ EFIS No. 137 (December 7, 2017) *Exhibit No. 209 - Direct Testimony of Greg R. Meyer* page 10 line 13, through page 12 line 14.

²⁹² EFIS No. 137 (December 7, 2017) *Exhibit No. 209 - Direct Testimony of Greg R. Meyer* page 5 line 1, through page 10 line 12.

rate and pre-payment penalty give the Glarners an advantage, even over Josiah Cox, because debt has priority over equity. No corresponding advantage to the customers is apparent.

Finally, the Commission conditioned Indian Hills' financing in the acquisition case on using those funds solely to buy and improve the system, but Indian Hills violated that directive by commingling those moneys with other Glarner entities.²⁹³ And Indian Hills has not been forthcoming as to the relationships among the Glarners' entities. That strongly suggests to the Commission that the Glarners never intended Indian Hills to pay interest to anyone but themselves, and did not intend to pay themselves at a market rate.

The Commission will order that the compliance tariffs shall include an amount in Indian Hills' rates and charges for cost of debt as sought by OPC.

OPC also asks that the Commission order that the compliance tariffs include no amount for the pre-payment penalty in Indian Hills' rates and charges. Under that penalty provision, refinancing the debt at a lower rate would perversely burden customers even more, because they would pay the refinanced interest rate and every penny of the 14 percent interest rate that was due over 20 years, even if Indian Hills uses that money for merely a couple of years.

The *Non-Unanimous Stipulation and Agreement* provides that, if the Commission orders the compliance tariffs to include an amount for cost of debt at 14 percent:

²⁹³ EFIS No. 128 (December 7, 2017) *Exhibit No. 200 - Direct Testimony of Keri Roth* (Confidential) page 13 line 1, through line 4.

. . . the Company agrees to submit a modification of loan agreement to reduce the prepayment penalty term from 20 years to 10 years.²⁹⁴

Indian Hills argues that such a modification can only happen under Indian Hills' consent.

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That may be true. Borrowers and lenders may make whatever provisions on penalties, interest rates, and other provisions that they find suitable for themselves, as the law provides. But how the Glarners' entities relate to one another is not before the Commission.

Before the Commission is the content of tariffs that will support safe and adequate service at just and reasonable rates. The Commission makes that determination on a preponderance of the evidence on the record. The record does not show that a 20-year, or even a 10-year, pre-payment penalty supports safe and adequate service at just and reasonable rates.

Because Indian Hills has not carried its burden of showing the amount of any pre-payment penalty that supports safe and adequate service at just and reasonable rates, the Commission will order that the tariffs shall include in rates and charges no amount for a pre-payment penalty.

Therefore, on the issue of cost of debt, the Commission will order the filing of compliance tariffs according to the OPC position statement.

²⁹⁴ EFIS No. 87 (November 22, 2017) *Non-Unanimous Stipulation and Agreement* page 6.

²⁹⁵ That provision unmistakably resembles the last-minute concession of a party to negotiations who, as the time for bargaining runs out, senses that it has over-reached.

iii. *Return on Equity.*

Staff's Initial Recommendation ²⁹⁶	OPC ²⁹⁷	Commission	Staff/Indian Hills Position Statement ²⁹⁸	Indian Hills ²⁹⁹
9.34%	9.34%	12%	12%	15.20%

The issues list and the prevailing position statement use the following language.

c. *What return on common equity should be used for determining rate of return?*

- *[R]eturn on equity (ROE) of 12%.*

Findings of Fact

1. Unlike debt, the return that investors demand for equity is not subject to direct observation.³⁰⁰ Financial analysis calculates return on equity by applying financial models to proxy groups of companies that have common equity costs based in the market.³⁰¹ No proxy group can be identical in risk to any single company, so adjustments may be appropriate.³⁰²

2. Cost of equity models (“models”) include³⁰³ the:

²⁹⁶ EFIS No. 112 (December 7, 2017) *Exhibit No. 100 - Direct Testimony of Natelle Dietrich* page 4 line 3, through line 10.

²⁹⁷ EFIS No. 169 (December 11, 2017) *Exhibit No. 213 - Direct Testimony of Michael P. Gorman* page 5 line 9, through line 11; EFIS No. 14 *Partial Disposition Agreement and Request for Evidentiary Hearing* Appendix 1, Attachment A second paragraph.

²⁹⁸ EFIS No. 87 (November 22, 2017) *Non-Unanimous Stipulation and Agreement* page 5 paragraph 5.

²⁹⁹ EFIS No. 91 (December 5, 2017) *Transcript - Volume 4 (Evidentiary Hearing 11 - 28 - 17)* page 400 line 10, through line 20.

³⁰⁰ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D'Ascendis* page 19 line 12, through line 13.

³⁰¹ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D'Ascendis* page 6 line 11, through line 17.

³⁰² EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D'Ascendis* page 6 line 17, through line 20.

³⁰³ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D'Ascendis* page 7)

- a. Discounted Cash Flow (“DCF”) model, single-stage constant growth version. That model assumes that an investor buys a stock for an expected total return rate, which is derived from cash flows received in the form of dividends plus appreciation in market price, and determines the present value of an expected future stream of net cash flows by discounting those cash flows at the cost of capital.³⁰⁴
- b. Risk Premium Model (“RPM”). Risk Premium considers that debt is less risky than equity, so stock issuers must offer a premium to attract investors over bonds. Generally, the risk premium is the difference between cost of debt and return on equity.³⁰⁵
- c. Capital Asset Pricing Model (“CAPM”). CAPM focuses on the degree of risk that distinguishes one investment from the market as a whole. CAPM multiplies risk in the market as a whole times the instability of an investment relative to the market as a whole, and adds the risk-free return rate to determine RoE.³⁰⁶

3. Indian Hills used two proxy groups: a group of eight regulated water utilities and a group of non-regulated companies of comparable risk.³⁰⁷ Applying the models to

³⁰⁴ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D’Ascendis* page 16 line 11, through line 21.

³⁰⁵ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D’Ascendis* page 19 line 14, through line 20.

³⁰⁶ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D’Ascendis* page 30 line 12, through line 20.

³⁰⁷ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D’Ascendis* page 7 line, through line 8.

Indian Hills' proxy groups yields a return on equity at 10.35 percent before any adjustments ("Indicated Common Equity Cost Rate before Adjustment").³⁰⁸

4. No financial risk adjustment is necessary to account for instability because the Commission is ordering a 50/50 capital structure for Indian Hills.³⁰⁹

5. An adjustment between 1.34 percent and 3.94 percent³¹⁰ for the system's extremely small size is reasonable.³¹¹

Discussion

Indian Hills' 12 percent cost of equity is the approximate half way point between the positions of OPC and Indian Hills, but splitting the difference is not the grounds for the Commission's ruling. The Commission is grounding its ruling on the method described in the testimony of Indian Hills' witness for return on equity, Dylan W. D'Ascendis.

Mr. D'Ascendis described how he used the characteristics of the proxy group. First, he examined the market-based equity costs of that group. Second he made adjustments for Indian Hills' unique risks relative to that proxy group. The Commission will apply that method as follows.

³⁰⁸ EFIS No. 103 (December 7, 2017) *Exhibit No. 10 - Direct Testimony of Dylan W. D'Ascendis* page 38 line 3, through line 17.

³⁰⁹ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 402 line 6, through line 9.

³¹⁰ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 402 line 12, through line 19. This is the testimony of Dylan W. D'Ascendis. Indian Hills' witness for return on equity.

³¹¹ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 402 line 12, through line 19. This is the testimony of Dylan W. D'Ascendis. Indian Hills' witness for return on equity.

The Commission has already compensated for the significant investment to remedy environmental non-compliance with a hypothetical capital structure of 50/50. That capital structure reduces risk and stabilizes a public utility's finances more than a 65/35 capital structure, which Indian Hills and Staff seeks; and even further below 77.12/22.88, which is the capital structure that Indian Hills claims to have.

The Commission concludes that a 12% return on equity represents what the market would pay for equity in Indian Hills. An adjustment of 1.65 percent for the risk represented by the system's extremely small size is reasonable. Adding that adjustment to the Indicated Common Equity Cost Rate before Adjustment of 10.35 percent results in a 12% return on equity.

Therefore, on the issue of return on equity, the Commission will order the filing of compliance tariffs according to the Staff/Indian Hills position statement.

C. Rate Design

The Commission is ordering that the compliance tariffs shall set forth a rate design, with a base charge and a seasonal volumetric rate, as described in Staff's primary scenario.³¹² The issues list and the prevailing position statement use the following language.

a. How should rates be developed based on the cost of service approved in this case?

b. Should a seasonal rate design be adopted in this case, and if so, what should be the structure of the seasonal and non-seasonal rates?

³¹² EFIS No. 179 (January 16, 2018) *Staff's Rate Design Scenarios*.

Base Charge	Volumetric rate (per 1,000 gallons)	
\$50.90	\$14.05	April -- September
	\$9.37	October – March

Since the Commission has ordered a revenue requirement less than Indian Hills sought, the Commission is also ordering that Customer bills shall reflect the difference between the revenue requirement that Indian Hills sought and the revenue requirement that the Commission is ordering. The compliance tariffs shall proportionally reduce each of the seasonal volumetric rates set forth in Staff’s primary scenario.

Findings of Fact

1. Generally, usage data helps to determine the costs that each type of customer is placing on the system and develop rates accordingly,³¹³ but current usage data for Indian Hills is limited.³¹⁴ Nevertheless other information about water systems in general and Indian Hills’ system in particular, assists in designing rate structure.

2. Any water system must be ready to meet peak demand with sufficient infrastructure all year,³¹⁵ even though the peak demand does not last all year.³¹⁶

³¹³ EFIS No. 119 (December 7, 2017) *Exhibit No. 107 - Rebuttal Testimony of Curtis B. Gateley* page 6 line 14, through line 18.

³¹⁴ EFIS No. 119 (December 7, 2017) *Exhibit No. 107 - Rebuttal Testimony of Curtis B. Gateley* page 6 line 14, through line 18.

³¹⁵ EFIS No. 119 (December 7, 2017) *Exhibit No. 107 - Rebuttal Testimony of Curtis B. Gateley* page 2 line 14, through line 15

³¹⁶ EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 4 line 16, through line 19.

Assumed principles underlying rate design also include assigning costs proportionally to the customers whose demands cause the costs.³¹⁷

3. Ways in which a water company may bill its customers for water service include the following:

a. A base charge is a flat amount that applies to each customer just for being a customer, because some expenses are necessary to run the system without regard to how much water a customer uses.³¹⁸

b. A volumetric rate, sometimes called a usage rate or a commodity rate, is an amount per gallon of water that passes through a customer's meter.³¹⁹

4. A volumetric rate too high could cause customers to modify their behavior to an extreme degree to avoid using water.³²⁰ If customers do not use enough water, Indian Hills will not have enough revenue to provide safe and adequate service.³²¹

5. Use of the system varies by season because only half of Indian Hills' customers are full-time residents, who reside in Indian Hills' service territory all year.³²²

³¹⁷ EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 4 line 19, through page 5 line 3.

³¹⁸ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 512 line 9, through line 14.

³¹⁹ EFIS No. 94 (December 7, 2017) *Exhibit No. 1 - Direct Testimony of Josiah Cox (Public & Confidential)* page 22 Line 1, through line 2.

³²⁰ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 509 line 16, through line 21.

³²¹ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 515 line 22, through page 516 line 4.

³²² EFIS No. 119 (December 7, 2017) *Exhibit No. 107 - Rebuttal Testimony of Curtis B. Gateley* page 3 line 15, through line 17.

The other half of Indian Hills' customers are part-time residents,³²³ who have another home elsewhere,³²⁴ and are more likely to be present in Indian Hills' service territory from April through September.³²⁵

6. April through September correspond approximately to Missouri lake recreation season used by MDNR in the context of Water Quality.³²⁶ During the lake recreation season, customers are all or almost all present, and the system is at its peak demand.³²⁷ In other words, the occasional presence of part-time residents and full-time residents determines peak demand, which determines the necessary capacity of the system.³²⁸

7. Therefore, a seasonally adjusted volumetric rate, shifting cost recovery towards the lake recreation season, spreads costs among more customers including those whose seasonal presence drives the peak that the system must meet.³²⁹

Discussion

In response to the Commission's post-hearing order, Staff filed rate design scenarios showing various configurations of amounts that Indian Hills could collect to

³²³ EFIS No. 119 (December 7, 2017) *Exhibit No. 107 - Rebuttal Testimony of Curtis B. Gateley* page 3 line 15, through line 17.

³²⁴ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 523 line 1, through line 11.

³²⁵ EFIS No. 113 (December 7, 2017) *Exhibit No. 101 - Direct Testimony of Curtis B. Gateley* page 11, through line 14.

³²⁶ MDNR regulation 10 CSR 20-7.031, Table A. EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 5 line 4, through line 9.

³²⁷ EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 4 line 7, though line 10.

³²⁸ EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 4 line 7, though line 10.

³²⁹ EFIS No. 96 (December 7, 2017) *Exhibit No. 3 - Surrebuttal Testimony of Josiah Cox* page 14 line 13, through page 5 line 3.

meet its revenue requirement. Neither Indian Hills nor OPC opposed any of those scenarios or provided alternatives. The Commission concludes that Staff's primary scenario represents the configuration that best balances Indian Hills' need for revenue with the customers' need for rates that are not oppressive.

The system must be able to provide service during peak usage times, so a rate design with a higher volumetric rate during the peak usage season will more efficiently pass costs to customers based on system use if properly implemented. This type of rate design, in conjunction with a standard monthly base charge, if properly implemented, will provide that users of the system, whether they are full time residents or second home owners, are bearing their share of Indian Hills' costs. Staff's primary scenario accomplishes this by shifting costs cautiously toward the months of April through September when the part-time residents are more likely using the system, and available to bear the costs of service, without jeopardizing Indian Hills' ability to collect revenue.

By contrast, OPC proposed a higher winter volumetric rate³³⁰ that would cause customers to use less water,³³¹ and threatens Indian Hills' ability to provide safe and adequate service.³³² OPC argues that its lesser customer charge or disconnection fees will stop customers from doing so, and argues that Indian Hills should give customers notice when seasonal rates change. No evidence shows that either measure would be effective.

³³⁰ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 509 line 22, though page 510 line 2.

³³¹ EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 509 line 8, through line 21.

³³² EFIS No. 91 (December 5, 2017) *Transcript-Volume 4 (Evidentiary Hearing 11-28-17)* page 515 line 22, through page 516 line 4.

Staff designed its primary scenario on the revenue requirement for which Staff argued as the Commission instructed. However, the Commission is ordering a revenue requirement less than that. Therefore, the compliance tariffs must collect a lesser amount than contemplated in Staff's primary scenario. The Commission will order that the difference shall appear in lesser volumetric charges for each season than set forth in Staff's primary scenario, so that water itself will be less costly.

Therefore, on the issue of rate design, the Commission will order the filing of compliance tariffs according to Staff's primary scenario with an adjustment to the volumetric rate as described.

IV. Orders

The Commission will order the filing of compliance tariffs pursuant to the determinations made in this report and order. The Commission will also order the filing of the reconciliation required by Section 386.420.4.

THE COMMISSION ORDERS THAT:

1. No later than February 14, 2018, Indian Hills Utility Operating Company, Inc. shall file the reconciliation as described in the body of this order.
2. No later than February 14, 2018, Indian Hills Utility Operating Company, Inc. shall file compliance tariffs as described in the body of this order.

3. This report and order shall be effective on February 17, 2018.

BY THE COMMISSION



A handwritten signature in black ink that reads "Morris L. Woodruff".

Morris L. Woodruff
Secretary

Hall, Chm., Kenney, Rupp, Coleman,
and Silvey, CC., concur;
and certify compliance with
Section 536.080, RSMo 2016.

Dated at Jefferson City, Missouri,
on this 7th day of February, 2018.

Appendix: Appearances

For:

Indian Hills Utility Operating Company, Inc.:
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Jefferson City, Missouri 65102-02230

Daniel Jordan, Senior Regulatory Law Judge.

STATE OF MISSOURI

OFFICE OF THE PUBLIC SERVICE COMMISSION

I have compared the preceding copy with the original on file in this office and I do hereby certify the same to be a true copy therefrom and the whole thereof.

WITNESS my hand and seal of the Public Service Commission,
at Jefferson City, Missouri, this 7th day of February 2018.




Morris L. Woodruff
Secretary

MISSOURI PUBLIC SERVICE COMMISSION

February 7, 2018

File/Case No. WR-2017-0259

**Missouri Public Service
Commission**

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Enclosed find a certified copy of an Order or Notice issued in the above-referenced matter(s).

Sincerely,



**Morris L. Woodruff
Secretary**

Recipients listed above with a valid e-mail address will receive electronic service. Recipients without a valid e-mail address will receive paper service.