

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

In the Matter of the Application                    )  
Of a Rate Increase For                                )  
Indian Hills Utility Operating                    )  
Company, Inc.    )  
**Case No. WR-2017-0259**

**Findings of Fact and Conclusions of Law**

**COMES NOW**, Staff of the Missouri Public Service Commission, by and through counsel, and for its *Findings of Fact and Conclusions of Law*, provides the following proposed findings of fact and conclusions of law for review and approval by the Commission:

**I.       General Matters**

**A. General Findings of Fact**

1.       Indian Hills Utility Operating Company, Inc. (“Indian Hills”), which holds the utility assets, is wholly owned by Indian Hills Utility Holding Company, Inc., which is wholly owned by First Round CSWR, LLC (“First Round”), which is managed by Central States Water Resources, Inc.<sup>1</sup> Indian Hills provides water service to approximately 715 residential customers, of which approximately half are part time with primary residence elsewhere, and half are full time, located near Cuba, Missouri.<sup>2</sup>

2.       The Office of the Public Counsel (“Public Counsel” or “OPC”) is a party to this case pursuant to Section 386.710(2), RSMo<sup>3</sup>, and by Commission Rule 4 CSR 240-2.010(10).

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<sup>1</sup> Ex. 1, *Direct Testimony of Josiah Cox*, p. 9.

<sup>2</sup> Ex. 1, *Direct Testimony of Josiah Cox*, p. 9.

<sup>3</sup> Unless otherwise stated, all statutory citations are to the Revised Statutes of Missouri, as codified in the year 2000 and subsequently revised or supplemented.

3. The Staff of the Missouri Public Service Commission (“Staff”) is a party to this case pursuant to Section 386.071, RSMo, and Commission Rule 4 CSR 240-2.010(10).

4. In File No. WO-2016-0045, Indian Hills applied to the Commission for approval to acquire its water system from I.H. Utilities, Inc.<sup>4</sup> Indian Hills sought permission to acquire the water assets and to issue indebtedness and encumber those assets in order to fund the construction necessary to bring the systems into regulatory compliance.<sup>5</sup> The Commission issued an order in that case on February 3, 2016, that approved a stipulation and agreement, which provided that Indian Hills should be authorized to acquire and operate the water system owned by I.H. Utilities, Inc. and imposed certain other financial conditions.<sup>6</sup> Indian Hills closed on the transaction with I.H. Utilities, Inc. on March 31, 2016.<sup>7</sup>

5. The water system was in a complete state of disrepair when Indian Hills acquired the utility assets of I.H. Utilities, Inc.<sup>8</sup>

6. When Indian Hills acquired the system, the system was not in compliance with Missouri Department of Natural Resource (“DNR”) standards.<sup>9</sup> In total, the system had 27 DNR compliance issues, due to years of general plant neglect and lack of

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<sup>4</sup> *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 Indebtness and Encumber Assets, Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity*, issued February 2, 2016.

<sup>5</sup> *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 Indebtness and Encumber Assets, Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity*, issued February 2, 2016.

<sup>6</sup> *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 Indebtness and Encumber Assets, Order Approving Transfer of Assets and Issuance of Certificate of Convenience and Necessity*, issued February 2, 2016.

<sup>7</sup> Ex. 1, *Direct Testimony of Josiah Cox*, p. 11.

<sup>8</sup> Ex. 105, *Direct Testimony of David A. Spratt*, p. 1.

<sup>9</sup> Ex. 105, *Direct Testimony of David A. Spratt*, p. 1.

investment by I.H. Utilities, Inc.<sup>10</sup> These DNR compliance issues revolved around 6 major areas: 1) inadequate number of drinking wells, 2) system reliability, 3) water loss, 4) system water pressure, 5) booster pumps, and 6) nominal storage requirements.<sup>11</sup>

7. Indian Hills began construction on system improvements approximately 30 days after it acquired the system and brought the system back into DNR compliance by November 2016.<sup>12</sup> Indian Hills invested \$1.84 million dollars into the system.<sup>13</sup>

8. In its original rate request letter, Indian Hills set forth its request for an increase of \$750,280 in its total annual water service operating revenues.<sup>14</sup>

9. Staff used a test year in this case consisting of the twelve months ending March 31, 2017.<sup>15</sup>

10. On September 1, 2017, the Commission's Staff and Indian Hills filed a *Partial Disposition Agreement and Request for Evidentiary Hearing*, including various attachments related to the disposition agreement ( "Agreement"). The Agreement was a partial resolution of Indian Hills' water rate request but left unresolved certain other issues for which Staff and Indian Hills requested an evidentiary hearing. Since Public Counsel objected to the Agreement, it is a joint position statement, but Staff and Indian Hills urge the Commission to adopt its terms. Public Counsel only objected to the disputed issues addressed at the evidentiary hearing. The Agreement is attached hereto as Attachment A and incorporated herein by reference as if fully set forth.

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<sup>10</sup> Ex. 1, *Direct Testimony of Josiah Cox*, p. 15.

<sup>11</sup> Ex. 1, *Direct Testimony of Josiah Cox*, p. 14.

<sup>12</sup> Ex. 1, *Direct Testimony of Josiah Cox*, p. 18, and Schedule JC-02.

<sup>13</sup> *Id.* at 21.

<sup>14</sup> See Request for Increase, filed April 4, 2017.

<sup>15</sup> Ex. 104, *Direct Testimony of Ashley Sarver*, Schedule AS-d3.

11. On November 22, 2017, Staff and Indian Hills filed a *Non-Unanimous Stipulation and Agreement* (“Stipulation”). This Stipulation resolves the case in total for revenue requirement of \$723,466. This is an increase of \$630,911 from the current total annualized revenues of \$97,291.<sup>16</sup> Since Public Counsel objected to the Stipulation, it is a joint position statement, but Staff and Indian Hills urge the Commission to adopt its terms. Public Counsel only objected to the disputed issues addressed at the evidentiary hearing. The Stipulation is attached hereto as Attachment B and incorporated herein by reference as if fully set forth.

12. The Commission finds that any given witness’ qualifications and overall credibility are not dispositive as to each and every portion of that witness’ testimony. The Commission gives each item or portion of a witness’ testimony individual weight based upon the detail, depth, knowledge, expertise, and credibility demonstrated with regard to that specific testimony. Consequently, the Commission will make additional specific weight and credibility decisions throughout this order as to specific items of testimony as is necessary.<sup>17</sup>

13. Any finding of fact reflecting that the Commission has made a determination between conflicting evidence is indicative that the Commission attributed greater weight to that evidence and found the source of that evidence more credible and more persuasive than that of the conflicting evidence.<sup>18</sup>

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<sup>16</sup> See Attachment B to the *Non-Unanimous Stipulation and Agreement*, filed November 22, 2017.

<sup>17</sup> Witness credibility is solely a matter for the fact-finder, “which is free to believe none, part, or all of the testimony”. *State ex rel. Public Counsel v. Missouri Public Service Comm’n*, 289 S.W.3d 240, 247 (Mo. App.2009).

<sup>18</sup> An administrative agency, as fact finder, also receives deference when choosing between conflicting evidence. *State ex rel. Missouri Office of Public Counsel v. Public Service Comm’n of State*, 293 S.W.3d 63, 80 (Mo. App. 2009).

## B. General Conclusions of Law

Indian Hills is a “water corporation” and a “public utility” as defined in Sections 386.020(59), 386.020(49), and 386.020(43), RSMo, respectively, and as such is subject to the personal jurisdiction, supervision, control and regulation of the Commission under Chapters 386 and 393 of the Missouri Revised Statutes. The Commission’s subject matter jurisdiction over Indian Hills’ rate increase request is established under Section 393.150, RSMo.

Sections 393.130 and 393.140, RSMo, mandate that the Commission ensure that all utilities are providing safe and adequate service and that all rates set by the Commission are just and reasonable. Section 393.150.2, RSMo, makes clear that at any hearing involving a requested rate increase the burden of proof to show the proposed increase is just and reasonable rests on the corporation seeking the rate increase. As the party requesting the rate increase, Indian Hills bears the burden of proving that its proposed rate increase is just and reasonable. In order to carry its burden of proof, Indian Hills must meet the preponderance of the evidence standard.<sup>19</sup> In order to meet this standard, Indian Hills must convince the Commission it is “more likely than not” that Indian Hills’ proposed rate increase is just and reasonable.<sup>20</sup> In determining whether the rates proposed by Indian Hills are just and reasonable, the Commission must balance the interests of the investor and the consumer.<sup>21</sup>

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<sup>19</sup> *Bonney v. Environmental Engineering, Inc.*, 224 S.W.3d 109, 120 (Mo. App. 2007); *State ex rel. Amrine v. Roper*, 102 S.W.3d 541, 548 (Mo. banc 2003); *Rodriguez v. Suzuki Motor Corp.*, 936 S.W.2d 104, 110 (Mo. banc 1996), citing to, *Addington v. Texas*, 441 U.S. 418, 423, 99 S.Ct. 1804, 1808, 60 L.Ed.2d 323, 329 (1979).

<sup>20</sup> *Holt v. Director of Revenue, State of Mo.*, 3 S.W.3d 427, 430 (Mo. App. 1999); *McNear v. Rhoades*, 992 S.W.2d 877, 885 (Mo. App. 1999); *Rodriguez v. Suzuki Motor Corp.*, 936 S.W.2d 104, 109 - 111 (Mo. banc 1996); *Wollen v. DePaul Health Center*, 828 S.W.2d 681, 685 (Mo. banc 1992).

<sup>21</sup> *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, (1944).

In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.<sup>22</sup>

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.<sup>23</sup>

The Supreme Court has further indicated:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.<sup>24</sup>

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<sup>22</sup> *Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 690 (1923).

<sup>23</sup> *Bluefield*, at 692-93.

<sup>24</sup> *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (citations omitted).

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.<sup>25</sup>

Furthermore, in quoting the United States Supreme Court in *Hope Natural Gas*, the Missouri Court of Appeals said:

[T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' ... Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts.<sup>26</sup>

Indian Hills and Staff signed and filed the Agreement and Stipulation, in which those parties reached agreement on most of the issues related to Indian Hills's rate increase requests. Public Counsel objected, but only as to the disputed issues that were addressed at the evidentiary hearing. Based on the evidence in this case, the Commission concludes that acceptance of the provisions of the Agreement and the Stipulation on the issues contained therein, other than those issues disputed at the evidentiary hearing, is a fair and reasonable resolution of those issues. The Commission will adopt the provisions of the Agreement, other than those issues disputed at the evidentiary hearing, as stated in Attachment A and B to this Report and Order.

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<sup>25</sup> *Federal Power Commission v. Natural Gas Pipeline Co.* 315 U.S. 575, 586 (1942).

<sup>26</sup> *State ex rel. Associated Natural Gas Co. v. Public Service Commission*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).

## **II. Disputed Issues**

### **Payroll**

- a. What are the appropriate job titles to be used in MERIC to compare and determine labor expense associated with Mr. Josiah Cox and Mr. Todd Thomas?*
- b. What are the appropriate MERIC salary wages?*
- c. Should the Employment Cost Index inflation rate be applied in setting such amounts?*
- d. What allocation factor (actual or assumed) should be used to determine payroll?*
- e. What level of experience should be used to set the labor expense associated with each employee?*

### **Findings of Fact**

1. Indian Hills has no employees. Several functions related to the operation of Indian Hills are provided by six employees of First Round CSWR, LLC (“First Round”). A portion of the costs associated with those employees is then allocated to Indian Hills.<sup>27</sup>

2. The Missouri Economic Research and Information Center (“MERIC”) is the research division for the Missouri Department of Economic Development. It provides analysis and assistance to policymakers and the public, including studies of the state’s targeted industries and economic development initiative.<sup>28</sup>

3. Staff developed the corporate payroll compensation for ratemaking purposes in this case by using MERIC data for the St. Louis region to compare regional

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<sup>27</sup> Ex. 104, *Direct Testimony of Ashley Sarver*, p. 2.

<sup>28</sup> Ex. 104, *Direct Testimony of Ashley Sarver*, p. 2.



base salaries to the base salary amounts sought by Indian Hills in this case for the six First Round employees.<sup>29</sup>

4. The MERIC system provides three levels of wage estimates for each occupation. Those levels are “entry level”, “mean level”, and “experienced level”. The entry level is the beginning level of each occupational study and is at the lowest pay level. The mean level is the mid-range of the pay scale and is an estimate of the hourly rate, which is calculated using the varying hourly rates of a group of workers in a specific occupation. The experienced level is at the top end of the scale, which are the highest paid employees in each occupation.<sup>30</sup>

5. OPC does not disagree with the general approach of using MERIC data to establish labor costs for ratemaking purposes.<sup>31</sup>

6. OPC agreed with Staff on not applying an Employment Cost Index inflation factor rate, using an assumed allocation factor, and using a mean level of experience and the job title of Construction Manager for Mr. Todd Thomas. Indian Hills and Staff’s stipulated payroll number was based off Staff’s EMS runs, utilizing those same positions for those issues.<sup>32</sup>

7. In determining the annual amount of payroll for the six employees, Staff used the mean level of the MERIC occupational study to annualize the payroll.<sup>33</sup>

8. Indian Hills uses the title of President for Mr. Cox.<sup>34</sup>

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<sup>29</sup> Ex. 104, *Direct Testimony of Ashley Sarver*, p. 3.

<sup>30</sup> Ex. 104, *Direct Testimony of Ashley Sarver*, p. 4.

<sup>31</sup> See OPC Position Statement, filed November 21, 2017.

<sup>32</sup> See OPC Position Statement, filed November 21, 2017.

<sup>33</sup> Ex. 104, *Direct Testimony of Ashley Sarver*, p. 4.

<sup>34</sup> Ex. 104, *Direct Testimony of Ashley Sarver*, p. 4.

9. Mr. Cox is responsible for the administration and operation of not only Indian Hills, but also four other regulated utilities, as well the acquisition activities of CSWR and the operation and administration of five wastewater treatment plants.<sup>35</sup>

10. Mr. Cox's job duties are "Lead and direct overall company strategy and direction, contact for financial regulatory compliance (PSC, OPC) and environmental regulatory compliance (MDNR, Attorney General), and director of all financing activities including debt and equity raises."<sup>36</sup>

11. In WR-2016-0064, the Commission found Chief Executive to be the appropriate job title and description for Mr. Cox. Hillcrest Utility Operating Company, Inc., is an affiliate of Indian Hills and also under the First Round umbrella.<sup>37</sup>

12. The job title President does not exist in MERIC.<sup>38</sup>

13. Staff used the 2015 MERIC wages as a proxy for a three year average for four employees, and the 2013 MERIC wages for two employees, including Mr. Cox.<sup>39</sup>

### **Conclusions of Law and Decision**

The Commission finds that the Staff's approach to resolving all payroll issues is the most reasonable. It is appropriate to select the "mean" experience level in using the MERIC data to establish labor expenses for each employee. The Employment Cost Index inflation rates should not be applied in setting the labor costs in this case. The appropriate salary should be those rates calculated by Staff based on its position on the above issues.

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<sup>35</sup> Ex. 1, *Direct Testimony of Josiah Cox*, p. 3-4.

<sup>36</sup> Ex. 200, *Direct Testimony of Keri Roth*, p. 4.

<sup>37</sup> *In the Matter of the Water Rate Request of Hillcrest Utility Operating Company, Inc.*, Case No. WR-2016-0064, **Report and Order**, filed July 12, 2016. ("Hillcrest") and Ex. 1, *Direct Testimony of Josiah Cox*, p. 3-4.

<sup>38</sup> Ex. 200, *Direct Testimony of Keri Roth*, p. 7.

<sup>39</sup> Ex. 104, *Direct Testimony of Ashley Sarver*, p.5, ll. 7-8.

The appropriate job titles to use in MERIC to determine labor expense for Mr. Cox is Chief Executive. This is closest to the title presently used by Indian Hills to describe that employee, and Staff's comparison of his job duties to MERIC found that these titles should continue to be used for ratemaking purposes. The Commission has already adopted use of Chief Executive in WR-2016-0064, another case involving a First Round subsidiary. Since Indian Hills is part of a group of commonly-owned regulated utilities and has plans to acquire additional utilities, it is appropriate to assign Mr. Cox's title similar to larger utilities rather than single utility companies.

### **Auditing and Tax Preparation Fees**

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

### **Findings of Fact**

1. Indian Hills has paid \$13,993 in auditing and tax preparation fees, with the invoices attached to the testimonies of Mr. Cox and Mr. Macias.<sup>40</sup>
2. A portion of this expense was paid outside of the test year.<sup>41</sup>
3. The Commission in the past has included certain known and measurable expenses that occur outside the test year, the most common examples being postage and union wages.<sup>42</sup>
4. All small companies prepare tax returns.<sup>43</sup>

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<sup>40</sup> Ex. 1, *Direct Testimony of Josiah Cox*, Schedule JC-03C Confidential, Ex. 5, *Rebuttal Testimony of Phil Macias*, Schedule PM-1R-C.

<sup>41</sup> Ex. 200, *Direct Testimony of Keri Roth*, p. 11.

<sup>42</sup> Tr.III, 224:16-24.

<sup>43</sup> Tr.III, 227:20-22.

5. Mr. Macias testified credibly that CSWR had been denied a loan based in part on a lack of audited financials.<sup>44</sup>

6. Mr. Cox testified credibly that every government funding source for water and wastewater improvements requires audited financials.<sup>45</sup>

### **Conclusions of Law and Decision**

The appropriate amount of auditing and tax preparation fees is \$13,993. These fees are known, as the fees have been paid, and measurable, as the final invoices detailing them have been submitted. The Commission in the past has included certain known and measurable expenses that occur shortly outside the test year, and finds this situation to be appropriate in which to exercise that discretion.

There is no rule that requires audited financials, however, an expense item or plant item does not have to be required by rule or statute to be included in a company's cost of service. The Commission declines to narrow the issue of prudence to if an expense or item was incurred under a specific law, regulation or act. Furthermore, credible testimony exists that audited financial statements are a necessary item in attracting government funding or private funding at lower rates, of which the pursuit benefits ratepayers. The auditing and tax preparation fees are properly included in the cost of service.

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<sup>44</sup> Tr. III, 212:22-25

<sup>45</sup> Ex. 1, *Direct Testimony of Josiah Cox*, p. 23, ll. 19-21.

## **Management Consulting Fees**

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

### **Findings of Fact**

1. Ms. Lois Stanley is the prior owner of Indian Hills.<sup>46</sup>
2. Ms. Stanley has been hired on a contract basis for three years to provide locational information in regards to the distribution facilities of Indian Hills.<sup>47</sup>
3. Indian Hills is a 50 year old system and maps of the distribution system do not exist.<sup>48</sup>
4. Ms. Stanley's services include locating existing isolation valves, which avoid the expense of installing new ones.<sup>49</sup>
5. Efficiently performed repairs and replacements save ratepayers time and hassle via less disruption of service and roads.<sup>50</sup>
6. Missouri One Call is a notification service that notifies public utilities whenever an excavator wants to dig within a given utility territory, and that utility is then required by law to locate and mark their own facilities.<sup>51</sup>
7. Indian Hills does not have another contractor, other than Ms. Stanley, specifically for line locates.

### **Conclusions of Law and Decision**

A management consulting fee of \$6,000 is appropriate to include in rates. A former owner is a useful source of information regarding a distribution system that is

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<sup>46</sup> Tr. III, 230:24- 231:1.

<sup>47</sup> Tr. III, 231:10-12.

<sup>48</sup> *Id.* at 247:1-3.

<sup>49</sup> *Id.* at 233:9-23.

<sup>50</sup> *Id.* at 246:18-247:14

<sup>51</sup> Sections 319.010 *et seq.* RSMo.

unmapped. Ms. Stanley has shown to be useful in this regard by locating where pipes are actually installed, saving Indian Hills from excavating the wrong side of the road, which saves ratepayers money, since only one dig is performed, and hassle, since the road and service is not disrupted by excavating and refilling the wrong side of the road and then excavating and refilling the correct side.<sup>52</sup> As Missouri One Call is a notification service and not a private locator service, there is no evidence that Indian Hills is duplicating services. Ms. Stanley's contract is appropriate to include in Indian Hill's cost of service.

### **Bank Fees**

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

### **Findings of Fact**

1. Indian Hills incurs a majority of its bank fees for a Lockbox service that receives payments from Indian Hills customers and records the cash receipts on behalf the company, processing payments much faster.<sup>53</sup>

2. The Lockbox service processing a large quantity of low dollar payments allows Indian Hills to avoid a labor intensive and time consuming project, and to only pay for the exact amount of expense required to complete this task, instead of hiring an additional employee.<sup>54</sup>

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<sup>52</sup> *Id.* at 238:1-15.

<sup>53</sup> Ex. 5, *Rebuttal Testimony of Phil Macias*, p. 12, ll. 2-14.

<sup>54</sup> *Id.*

3. The Lockbox also enhances the cash flow of the company, and for a small utility, enhanced cash flow is vital to meet the ongoing maintenance and repair of a small system.<sup>55</sup>

4. There are no affiliate transaction rules applicable to water.<sup>56</sup>

5. No evidence was offered at hearing or in the pre-filed testimony that Indian Hills could perform bank services in house at a lower rate.

6. If the Stipulation is approved, Indian Hills has agreed to perform an analysis of its bank fees within 180 days of a Commission order setting new rates.<sup>57</sup>

### **Conclusions of Law and Decision**

The appropriate level of bank fees to include in the cost of service for Indian Hills is \$4,714. There has been no substantive proof offered at hearing or in the pre-filed testimony that Indian Hills could perform bank services in house at a lower rate. . OPC's argument regarding affiliate transactions also fails, as there are no affiliate transaction rules applicable to water. Even for utilities that operate under affiliate transaction rules, there must be a showing that ratepayers were harmed by the utility operating imprudently. No serious doubt has been raised regarding the prudence of this expenditure, so Indian Hills should be allowed to recoup prudently incurred bank fees.

### **Rate Case Expense**

*What is the appropriate rate case expense to include in the cost of service for Indian Hills?*

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<sup>55</sup> Tr. III, 251:15-18.

<sup>56</sup> See 4 CSR 240

<sup>57</sup> *Non-Unanimous Stipulation and Agreement*, filed November 22, 2017, p. 2.

## Findings of Fact

1. Rate case expense can benefit both utility shareholders and customers, though often in different ways.<sup>58</sup>
  2. Indian Hills hired two rate of return experts.<sup>59</sup>
  3. The hourly rate charged by one of Indian Hill's consultants is much higher than what is typically charged hourly by other consultants in both large and small utility proceedings.<sup>60</sup>
  4. OPC proposes ratepayers be responsible for no more than \$250 an hour of the actual hourly rate charged by the two consultants.<sup>61</sup>
  5. Staff proposes a 50/50 sharing of the cost of two rate of return experts between ratepayers and Indian Hills.<sup>62</sup>
4. If the Stipulation is approved, Indian Hills' rate case expense number is frozen, and there will be no true-up to increase the rate case expense incurred in this case due to the hearing.<sup>63</sup> If the Stipulation is not approved, Indian Hills will be able to submit a higher, final rate case expense number to be included in the cost of service.

## Conclusions of Law and Decision

The Commission finds Staff's position to be the most reasonable resolution of the issue. Staff's position recognizes a 50/50 sharing of the cost of two outside consultants on rate of return. The Commission has the legal authority to apportion rate case

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<sup>58</sup> *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service*, File No. ER-2014-0370, **Report and Order** issued September 2, 2015, p. 64.

<sup>59</sup> Ex. 219 *September 20, 2017 Letter to Josiah Cox from Dylan W. D'Ascendis, Scott Madden Management Consultants* and Ex. 220 *September 14, 2017 Letter to Josiah M. Cox from Michael E. Thaman, Warson Capital Partners (Confidential)*

<sup>60</sup> Ex. 203, *Surrebuttal Testimony of Keri Roth*, p. 10.

<sup>61</sup> Ex. 203, *Surrebuttal Testimony of Keri Roth*, p. 10.

<sup>62</sup> Ex.111, *Surrebuttal Testimony of Jennifer K. Grisham*, p. 2, ll. 13-20.



expenses between ratepayers and shareholders and it is appropriate to do so when the inclusion of all the rate case expenses for payment by ratepayers would not be just and reasonable. The Commission has apportioned based on a sharing mechanism in the past, and does so here, instead of an hourly cap. A five year normalization period is also appropriate to reduce the amount of per year expense ratepayers would incur yearly for attorney fees.

### **Treatment of Leak Repair Costs**

- a. *What are the appropriate accounts to book leak repair?*
- b. *What is the appropriate level of leak repair to include in the cost of service?*

### **Findings of Fact**

1. The Commission can prescribe uniform methods of keeping accounts, records and books, to be observed by water corporations.<sup>64</sup>
2. Water corporations must use the Uniform System of Accounts.<sup>65</sup>
3. OPC argues that repair expense should be recorded in plant accounts, specifically Account 343 Transmission and Distribution Mains.<sup>66</sup>
4. Staff and Indian Hills argue repair expense should be recorded in operation and maintenance expense accounts.<sup>67</sup>
3. The USOA provides a list of maintenance items to describe work that qualifies as operating expenses; item 3 states that work performed specifically for the

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<sup>64</sup> RSMo. 393. 140(4).

<sup>65</sup> 4 CSR 240-50.030(1).

<sup>66</sup> See OPC Position Statement, filed November 21, 2017, p. 5.

<sup>67</sup> Ex. 109, *Rebuttal Testimony of Stephen Moilanen, P.E.*, p. 3, ll. 15-16.

purpose of preventing failure, restoring serviceability or maintain life of plant is to be booked as an operating expense.<sup>68</sup>

4. The USOA instructs that a minor item of property be charged to a maintenance account, unless a substantial addition results and substantial means something of considerable size, importance, or worth.<sup>69</sup>

5. The definition of repair is work performed to restore service, maintain life, or prevent failures.<sup>70</sup>

6. Indian Hills' distribution system is 50 years old and until Mr. Cox took over the system, did not receive many of the necessary capital improvements.<sup>71</sup>

7. Much of the system is still original, and any repairs made previously were made with substandard material.<sup>72</sup>

8. It is not practical to replace the entire system wholesale.<sup>73</sup>

9. The condition of the piping and materials will make ongoing repairs necessary to prevent loss of service to customers and damage to property.<sup>74</sup>

10. It will not always be feasible to make a replacement instead of a repair, for instance the location of the leak and the cost to replace versus repair may make a repair the better alternative for ratepayers.<sup>75</sup>

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<sup>68</sup> *Id.*

<sup>69</sup> Ex. 115, Utility Plant Instructions.

<sup>70</sup> Tr. III, 344:9-13.

<sup>71</sup> Ex. 105, *Direct Testimony of David A. Spratt*, p. 3, ll. 2-4.

<sup>72</sup> *Id.* at ll. 3-7.

<sup>73</sup> Ex. 6, *Surrebuttal Testimony of Phil Macias*, p. 2, ll. 18-19.

<sup>74</sup> Ex. 113, *Surrebuttal Testimony of David A. Spratt*, p. 1, ll. 19-21, Tr. III, 323:4-13.

<sup>75</sup> Tr. III, 301:5-15.

11. In order to improve the reliability of the system and meet DNR requirements, certain upgrades to address pressure, water availability and service stability were performed that caused the system to experience more leaks.<sup>76</sup>

12. Indian Hills has only a year of historical data on leak repair expense and does not know where, how, or when repair issues will arise due to the severe disrepair state of the system.<sup>77</sup>

13. The current data is not sufficient to predict how leak repair expense will trend, as it only contains a few months of leak repair expense due to the increase in pressure due to new booster stations required by DNR.<sup>78</sup>

14. A tracker compares the actual cost a company incurs to the baseline set in rates.<sup>79</sup>

15. A company has an opportunity, but not a guarantee, to collect and amortize amounts spent over the baseline in their next rate case.<sup>80</sup>

16. Conversely, if a company spends less than the baseline amount, customers may receive credit for amounts contributed that the company did not utilize.<sup>81</sup>

17. The Commission has approved trackers in limited circumstances for costs that are volatile and costs for which there is no historical data, such as pensions and

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<sup>76</sup> Ex. 8, *Rebuttal Testimony of Todd Thomas*, p. 8, ll. 19-20.

<sup>77</sup> Ex. 6, *Surrebuttal Testimony of Phil Macias*, p. 2, ll. 20-21.

<sup>78</sup> Ex. 7, *Direct Testimony of Todd Thomas*, p. 6, ll. 15-18.

<sup>79</sup> Tr. IV, 388:3-15.

<sup>80</sup> *Id.* at 391:8-12.

<sup>81</sup> *Id.* at 392:1-3.

other post-employment benefits and the vegetation management trackers, respectively.<sup>82</sup>

18. No customer notice is required for a tracker and trackers are not interim rate adjustments.<sup>83</sup>

19. Any amounts over or under collected from the base amount in rates is examined in the next rate case.<sup>84</sup>

20. If the Stipulation is approved, Indian Hills has agreed to Distribution System Improvement Plan to study the system and submit and schedule to replace the distribution system.

### **Conclusions of Law and Decision**

The appropriate account to book leak repair expense is in maintenance and operation accounts. Leak repair expense squarely falls within the definition of work performed preventing failure, restoring serviceability or maintain life of plant because the purpose of a repair is to restore proper function to the system. Therefore it is appropriate to follow the USOA guidelines and book this expense to maintenance accounts. It is inappropriate to book repair expense in plant accounts, since a clamp or minor pipe section is not a substantial addition, and therefore inappropriate for a plant account.

The appropriate amount of leak repair expense is \$90,000 and a two-way tracker should be put in place to record amounts expended over or under this baseline. Indian Hills' distribution system will still need continuing work in the future to maintain system

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<sup>82</sup> *Id.* at 4-15.

<sup>83</sup> Tr. III, 360:6-20.

<sup>84</sup> Tr. IV, 393:16-20.

reliability. Replacements will not always be feasible, and immediate repair is preferable to system failure or property damage. To incentivize Indian Hills to continue to maintain the system through prudent repairs means Indian Hills must be allowed possibility of future recovery of any expenses incurred over the baseline costs. A two-way tracker also safeguards the ratepayers from overpaying for repair expense if future repair expense does not materialize at the current level. Since Indian Hills has recently made DNR required system upgrades, it is unknown what the full impact of those upgrades will be on the system as it relates to leaks. Since Indian Hills is facing a cost for which there is little to no historical data, the Commission finds this to be an appropriate use of a tracking mechanism.

### **Extension of Electric Service**

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

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

### **Findings of Fact**

1. Indian Hills was required to incur the electric line extension expense to provide service; these costs were directly associated with the construction of the new well, booster pumps, ground storage and well house.<sup>85</sup>

2. An item does not need to be owned by a utility for it to be capitalized, for instance, items such as delivery expenses, sales taxes, or other costs associated with construction activities can be capitalized.<sup>86</sup>

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<sup>85</sup>Ex. 6, *Surrebuttal Testimony of Phil Macias*, p. 4.

<sup>86</sup>Tr. III, 363:1-25.

3. As long as the goods or services were incurred to prepare the plant to be used and useful, USOA and generally accepted accounting practices (“GAAP”) allow for capitalization.<sup>87</sup>

4. Indian Hills paid the full amount of the electric line-extension service costs on May 17, 2016.<sup>88</sup>

5. The USOA Account 325 states, “this account shall include the cost installed of pumping equipment driven by electric power” and items to be booked under this account include “5. Electric power lines and switching.”

6. Installation costs are allowable under the USOA and GAAP.<sup>89</sup>

### **Conclusions of Law and Decision**

Indian Hills should be able to capitalize the electric line extension expense. Since these costs were ordinary, necessary cost directly associated with the new well, booster pumps, ground storage, and well house. An item does not need to be owned by a utility for it to be capitalized. Items such as inspection costs, delivery expenses or other costs associated with construction activities are appropriate for capitalization under USOA and GAAP guidance.

The appropriate account to record the extension of electric line service in is Account 325 as this account includes the cost installed of pumping equipment driven by electric power.” Items to be booked under this account include “5. Electric power lines and switching.” Installation costs are allowable under the USOA and GAAP, therefore

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<sup>87</sup> Ex. 6, *Surrebuttal Testimony of Phil Macias*, p. 4.

<sup>88</sup> *Id.*

<sup>89</sup> Ex. 6, *Surrebuttal Testimony of Phil Macias*, p. 3-4.

the \$23,000 installation payment for the extension is appropriate to book under account 325.

### **Rate Design**

- 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?*

### **Findings of Fact**

1. All parties, in testimony or by Stipulation, supported seasonal rates; the remaining issue is what structure the seasonal and non-seasonal rates should take.
2. Currently, limited usage data exists.<sup>90</sup>
3. Part-time users are more likely to be present and using the system in the summer months.<sup>91</sup>
4. Part-time residents are those residents who have a second home elsewhere; full-time residents are those residents who reside at the area Indian Hills serves year round.<sup>92</sup>
4. Staff and Indian Hill's rate design as stipulated shifts cost recovery towards the summer months.<sup>93</sup>
5. OPC's rate design consists of a \$6.06 commodity charge in the summer months and a winter commodity charge of \$16.11.<sup>94</sup>

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<sup>90</sup> See OPC Position Statement, filed November 21, 2017, p. 6.

<sup>91</sup> Tr. IV, 508:17-19.

<sup>92</sup> *Id.* at 523:1-10.

<sup>93</sup> Tr. IV, 508:17-19.

<sup>94</sup> Ex. 212, *Direct Testimony of Geoff Marke*, p. 5.

6. A \$16.11 commodity charge is unusually high and could cause customers to modify their behavior to such an extreme degree to avoid using water, to their detriment.<sup>95</sup>

7. Mr. Gateley testified credibly that “it is not a situation where a company might not earn the profit that they’re entitled [for] a chance to earn but it’s a situation potentially of a catastrophically short amount of revenue coming in”, and could lead to a situation where Indian Hills cannot maintain safe and adequate service.<sup>96</sup>

8. If the Stipulation is approved, Indian Hills will also submit usage data to Staff and OPC, allowing the parties to adjust and refine the rate design in a future rate case, to better align rates with principles of cost causation and other policies the Commission upholds.<sup>97</sup>

### **Conclusions of Law and Decision**

Due to the lack of usage data, a moderate seasonal rate design is the most cautious way to employ seasonal rates without causing a large impact to ratepayers. A high winter commodity charge disproportionately impacts the full-time residents, and could cause extreme behaviors modifications so users avoid using water. This is risky for both customers for health and safety reasons, and the utility, as a healthy revenue stream is vital for the continuation of safe and adequate service. A moderate approach is appropriate until more usage data is submitted.

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<sup>95</sup> *Id.* at 509:16-21.

<sup>96</sup> *Id.* at 513:20-23.

<sup>97</sup> *Id.* at 5-21.



## **IX. Rate of Return:**

### **Findings of Fact:**

1. In 2016, Indian Hills acquired a 50-year old drinking water system serving 715 homes.<sup>98</sup>
2. No significant capital improvements had been made since its original construction.<sup>99</sup>
3. The system was in significant disrepair when acquired and had no less than six major areas of critical concern including limited water sources, system reliability, water loss, water pressure, lack of redundancy, and storage capacity.<sup>100</sup>
4. There were 27 distinct noncompliance issues with Missouri Department of Natural Resources requirements.<sup>101</sup>
5. Since the acquisition, Indian Hills has invested \$1.84 million in significant capital improvements.<sup>102</sup>
6. In a non-unanimous stipulation and agreement, Staff agreed to an annual revenue requirement increase of \$630,911.
7. Since the acquisition, Indian Hills' operating costs have exceeded its revenue by \$371,611.66.<sup>103</sup>

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<sup>98</sup> Ex. 1, Cox Direct, pp. 9-11.

<sup>99</sup> Ex. 1, Cox Direct, p. 11.

<sup>100</sup> Ex. 1, Cox Direct, pp. 11-15.

<sup>101</sup> Ex. 1, Cox Direct, pp. 15-17.

<sup>102</sup> Ex. 1, Cox Direct, pp. 17-21.

<sup>103</sup> Ex. 1, Cox Direct, p. 26, line 19.

8. Staff recommends a hypothetical capital structure of 35% equity to 65% debt.<sup>104</sup> This ratio was agreed by both Staff and the Company in a non-unanimous stipulation and agreement dated November 21, 2017.<sup>105</sup>

9. Staff often proposes the use of a hypothetical capital structure when the actual capital structure is inappropriate for ratemaking purposes, particularly for small or distressed companies. Staff witness Matt Barnes explained:

Staff typically proposes a hypothetical capital structure when the company is not rated by a credit rating agency, such as Indian Hills, they don't issue their own stock, they're not publicly traded. So it's very difficult to -- it's kind of difficult to come up with an actual capital structure.<sup>106</sup>

10. Indian Hills asserts that its actual capital structure is 77.12% long-term debt and 22.88% equity;<sup>107</sup> however, Public Counsel witness Mike. Gorman testified that the utility's financial statements "simply didn't support it."<sup>108</sup> Mr. Gorman expressed doubt that this even is Indian Hills' actual capital structure.<sup>109</sup> Based on DR responses, he suggested that the actual capital structure contains almost no equity.<sup>110</sup>

11. Company witnesses Josiah Cox and Dylan D'Ascendis testified that the Commission should use the Company's actual capital structure in recognition of the practical difficulties in obtaining capital for small water and sewer operations.<sup>111</sup>

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<sup>104</sup> Ex. 100, Dietrich Direct, p. 4, lines 5-9.

<sup>105</sup> By its terms, the non-unanimous stipulation and agreement is void because not approved by the Commission. See Paragraph 15.

<sup>106</sup> Tr. 6:545, lines 2-8.

<sup>107</sup> Ex. 10, D'Ascendis Direct, p. 4, lines 9-11.

<sup>108</sup> Tr. 6:557, lines 6-8.

<sup>109</sup> Ex. 215, Gorman Rebuttal, p. 3, lines 1-11.

<sup>110</sup> Ex. 215, Gorman Rebuttal, p. 3.

<sup>111</sup> Ex. 1, Cox Direct, pp. 24-28; Ex. 10, D'Ascendis Direct, pp. 4-6.

12. Mr. Gorman testified that, due to its negligible equity component, the capital structure proposed by the Company is not appropriate for ratemaking purposes.<sup>112</sup>

13. Mr. Gorman testified, "IHUOC's actual capital structure has a *de minimis* amount of common equity. Effectively, this utility is almost exclusively debt financed."<sup>113</sup> Mr. Gorman testified that Indian Hills' actual capital structure is not appropriate for ratemaking purposes and that the Commission should use a hypothetical capital structure and require the Company to make efforts to conform its actual capital structure to it.<sup>114</sup>

14. Mr. Gorman testified that Staff's proposed hypothetical capital structure is supported by the public interest.<sup>115</sup>

15. OPC's position is that the Commission should use a hypothetical, 50-50 capital structure and require Indian Hills to work toward achieving it in actuality.

16. OPC's own expert witness, Mike Gorman, noted that the Company is almost entirely financed by debt and testified that the public interest supports the use of Staff's hypothetical capital structure, which contains significantly more debt than does OPC's.<sup>116</sup>

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<sup>112</sup> Ex. 214, Gorman Rebuttal, p. 3, lines 12-16. Mr. Gorman expressed doubt that this even is Indian Hills' actual capital structure. *Id.*, p. 3, lines 1-11. Based on DR responses, he suggested that the actual capital structure contains almost no equity. *Id.*

<sup>113</sup> Ex. 216, Gorman Surrebuttal, p. 4, lines 20-21.

<sup>114</sup> Ex. 216, Gorman Surrebuttal, p. 4, lines 18-23, through p. 5, lines 1-9.

<sup>115</sup> Ex. 215, Gorman Rebuttal, p. 3, lines 16-19.

<sup>116</sup> Ex. 216, Gorman Surrebuttal, p. 4, lines 18-23, through p. 5, lines 1-9; Ex. 215, Gorman Rebuttal, p. 3, lines 16-19; Tr. 6:556, line 24, through p. 557, line 1.

17. The actual cost of Indian Hills' long-term debt is 14%.<sup>117</sup> Mr. Gorman admitted as much.<sup>118</sup>

18. Staff agreed to use the 14% cost of debt in the *Partial Disposition Agreement* executed between the Company and Staff on September 1, 2017, and again in the non-unanimous stipulation and agreement dated November 21, 2017.

19. Staff witness Natelle Dietrich supported the 14% cost of debt in her testimony<sup>119</sup> and it is Staff's position in this case that the appropriate cost of debt input for ratemaking is 14%.

20. Mr. Gorman admitted that he did not know of any alternative lender that was actually willing to lend money to Indian Hills at less than 14%.<sup>120</sup>

21. OPC strongly opposes the use of 14% as the cost-of-debt input.<sup>121</sup>

22. Consultant Greg Meyer testified on behalf of OPC that the 14% annual interest rate and the prepayment amount clause caused him "concern."<sup>122</sup> The 14% rate, in his opinion, is "excessive";<sup>123</sup> and he considers the prepayment clause "unreasonable."<sup>124</sup>

23. OPC witness Gorman testified that the prepayment clause was "not that unusual."<sup>125</sup>

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<sup>117</sup> Ex. 13, Thaman Direct, p. 4, lines 3-4; Tr. 4:408, lines 10-14; Ex. 208, Meyer Direct, p. 4, lines 1-12.

<sup>118</sup> Tr. 6:559, lines 15-20.

<sup>119</sup> Ex. 100, Dietrich Direct, p. 4, lines 5-9.

<sup>120</sup> Tr. 6:560, lines 1-12.

<sup>121</sup> Ex. 208, Meyer Direct, pp. 12-13; Ex. 211, Meyer Surrebuttal, p. 6, line 16, through p. 8, line 5; Ex. 213, Gorman Direct, p. 2, lines 6-15; Ex. 214, Gorman Rebuttal, p. 4, lines 1-6; Ex. 216, Gorman Surrebuttal, pp. 5-6;

<sup>122</sup> Ex. 208, Meyer Direct, p. 12, lines 15-19.

<sup>123</sup> Ex. 208, Meyer Direct, p. 13, line 2; p. 14, line 9; Ex. 211, Meyer Surrebuttal, p. 7, line 5; p. 11, line 5.

<sup>124</sup> Ex. 208, Meyer Direct, p. 13, lines 2-6.

<sup>125</sup> Tr. 6:552, lines 11-12.

24. Mr. Meyer further testified that he was not able to conclude, based on his analysis of documents provided by the Company, that Indian Hills was not able to obtain financing on more reasonable terms.<sup>126</sup>

25. Mr. Gorman testified that the 14% rate was “significantly above the market cost of debt for distressed utility companies.”<sup>127</sup>

26. Mr. Meyer also was concerned by evidence of transfers between various companies controlled by Mr. Cox and by the roles of Robert Glarner, Jr., and David Glarner, and entities controlled by them, as equity investors, debt investors, and bankers for Indian Hills and other of Mr. Cox’s companies.<sup>128</sup>

27. Mr. Meyer commented, “These transactions are not being performed at an arm’s length and the Commission should be cautious of self-dealing as it proceeds.”<sup>129</sup>

28. Indian Hills presented the testimony of Michael Thaman, Sr., an experienced expert in the field of business finance.<sup>130</sup>

29. Mr. Thaman testified, “In my opinion, the risk profile of small utilities in the condition of Indian Hills, particularly with respect to financial position, results of operations, out-of-compliance status, regulatory control of utility rates and related issues, and the potential for unknown contingent liabilities (“Distressed Utilities”), is such that traditional bank financing is not available.”<sup>131</sup>

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<sup>126</sup> Ex. 208, Meyer Direct, p. 12, lines 8-14.

<sup>127</sup> Tr. 6:552, lines 21-23.

<sup>128</sup> Ex. 208, Meyer Direct, pp. 1-10.

<sup>129</sup> Ex. 208, Meyer Direct, p. 14, lines 22-23.

<sup>130</sup> Ex. 13, Thaman Direct, pp. 1-2 (experience); Thaman Rebuttal, p. 5.

<sup>131</sup> Ex. 13, Thaman Direct, p. 4, lines 9-13; see Ex. 10, D’Ascendis Direct, p. 3, lines 5-12; p. 6, lines 6-9.

30. Mr. Cox explained: “Unfortunately with these small utilities there are almost no tangible assets, you know, at the time of acquisition, and then the existing cash flows are minimal.”<sup>132</sup>

31. Noting the “significant high-risk characteristics” in an investment in a distressed utility such as Indian Hills,<sup>133</sup> Mr. Thaman pointed out that “very few sources of financing are available.”<sup>134</sup>

32. Financing for Indian Hills and other distressed utilities, in Mr. Thaman’s opinion, might only be available from “high-risk investors . . . in exchange for a commensurate rate of interest.”<sup>135</sup>

33. The interest rate for such financing, in Mr. Thaman’s opinion, might range between 15% and 21%.<sup>136</sup>

34. Mr. Thaman noted that “the underlying assumptions to Mr. Gorman’s hypothetical analysis bear no resemblance to the reality of securing financing for a very small, distressed and unrated utility such as Indian Hills.”<sup>137</sup>

35. Mr. Thaman dismissed as “invalid” Mr. Gorman’s use of Dayton Power & Light (“DPL”), a below-investment grade electric utility, as a proxy for Indian Hills given that DPL has 519,000 customers compared to Indian Hills’ 715; annual revenues of \$1.3 billion compared to Indian Hills’ \$73,120; assets of \$1.9 billion compared to Indian Hills’ \$2.2 million; and is rated by either S&P or Moody’s or both, whereas

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<sup>132</sup> Tr. 4:428, lines 15-18.

<sup>133</sup> Mr. Meyer denies that Indian Hills is a distressed utility; Ex. 211, Meyer Surrebuttal, p. 5, lines 11-19.

<sup>134</sup> Ex. 13, Thaman Direct, p. 4, lines 14-17.

<sup>135</sup> Ex. 13, Thaman Direct, p. 4, line 22, through p. 5, line 4.

<sup>136</sup> Ex. 13, Thaman Direct, p. 5, lines 11-14. Note that Indian Hills’ actual rate of 14% is lower than the range cited by Mr. Thaman.

<sup>137</sup> Ex. 14, Thaman Rebuttal, p. 2, lines 12-14.

Indian Hills is unrated.<sup>138</sup>

36. Noting that “[c]learly, DPL and Indian Hills are in no way comparable,”<sup>139</sup> Mr. Thaman urged the Commission to “dismiss” Mr. Gorman’s invalid comparison and the lessons purportedly drawn from it.<sup>140</sup>

37. Based on his long experience, Mr. Thaman testified that “I know of no source of financing for the Company on terms more favorable than its existing arrangement.”<sup>141</sup>

38. Mr. Gorman could not identify an alternative lender.<sup>142</sup>

39. The schedule of small water and sewer companies with purportedly lower debt costs assembled by Mr. Meyer was convincingly shown to be unreliable.<sup>143</sup>

40. Staff recommends a return on common equity (“ROE”) of 12.00% based on the non-unanimous stipulation and agreement dated November 21, 2017.<sup>144</sup>

41. The Company presented the expert testimony of Dylan W. D’Ascendis, who recommends an ROE of 15.20%.<sup>145</sup>

42. Mr. Gorman recommends 9.34% based on certain of Mr. D’Ascendis’ analyses.

43. Mr. D’Ascendis applied three commonly used analytical methods, the Discounted Cash Flow (“DCF”), the Predictive Risk Premium Model (“PRPM”), and the

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<sup>138</sup> Ex. 14, Thaman Rebuttal, pp. 2-4, esp. chart on p. 3.

<sup>139</sup> Ex. 14, Thaman Rebuttal, p. 4, line 3.

<sup>140</sup> Ex. 14, Thaman Rebuttal, p. 2, lines 14-16; p. 4, lines 7-11.

<sup>141</sup> Ex. 14, Thaman Rebuttal, p. 7, lines 11-13; Tr. 4:408, lines 15-18.

<sup>142</sup> Tr. 6:560, lines 1-12.

<sup>143</sup> Sch. GRM-SUR-2; Ex. 15; Tr. 4:466, line 25, through p. 470, line 20; p. 472, line 15, through p. 478, line 10.

<sup>144</sup> Staff’s ROE position in its position statement and in the Direct Testimony of Natelle Dietrich are incorrect in that Staff’s original position of 9.34% has been superseded by the agreed value of 12.00% in the non-unanimous stipulation and agreement.

<sup>145</sup> Ex. 10, D’Ascendis Direct, p. 2, line 16; p. 6, lines 12-13; Sch. DWD-1.

Capital Asset Pricing Model (“CAPM”) to market-driven data reflecting two proxy groups, one a group of eight regulated water utilities and the other a group of non-regulated companies of comparable risk.<sup>146</sup> He then applied upward adjustments to his initial result of 10.35% -- 2.49% for financial risk and 2.38% for small size, reaching a final figure of 15.22%, which he rounded down in developing his recommendation of 15.20%.<sup>147</sup>

44. OPC expert witness Gorman criticized Mr. D’Ascendis’ methodology and results, particularly his ECAPM study.<sup>148</sup>

45. Mr. Gorman testified:

A reasonable range in return on equity estimates for IHUOC should be considered to reflect his [i.e., Mr. D’Ascendis’] DCF return estimate of 8.63%, and his traditional CAPM result of 9.94%. Staff’s recommended return on equity for IHUOC falls within this range, and thus Mr. D’Ascendis’ testimony supports the reasonableness of this finding. However, all of Mr. D’Ascendis’ other risk premium studies and external adjustments for IHUOC are without merit and should be disregarded.<sup>149</sup>

46. OPC adopted Staff’s pre-stipulation ROE recommendation of 9.34%.

47. Normally, the return on equity is set higher than the cost of debt, as Mr. D’Ascendis pointed out.<sup>150</sup> However, the financing of Indian Hills is anything but normal, as Mr. Cox, Mr. D’Ascendis and Mr. Thaman acknowledged.<sup>151</sup>

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<sup>146</sup> Ex. 10, D’Ascendis Direct, p. 7.

<sup>147</sup> Ex. 10, D’Ascendis Direct, pp. 7-8.

<sup>148</sup> Ex. 215, Gorman Rebuttal, p. 5.

<sup>149</sup> Ex. 215, Gorman Rebuttal, p. 5, line 24, through p. 6, line 4.

<sup>150</sup> Ex. 10, D’Ascendis Direct, p. 3, lines 13-14; *and see* Gorman at Tr. 6:563, line 22, through p. 564, line

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<sup>151</sup> Ex. 13, Thaman Direct, p. 4, lines 9-13; *see* Ex. 10, D’Ascendis Direct, p. 3, lines 5-12; p. 6, lines 6-9.



## Conclusions of Law:

In determining this case, the Commission must be mindful of the Constitutional parameters that guide regulatory decision-making. In two frequently-cited decisions,<sup>152</sup> the United States Supreme Court described certain principles with which the Commission's decision must comply:

(1) An adequate return is commensurate with the returns realized from other businesses with similar risks. This is the principle of the commensurate return.

(2) An adequate return is sufficient to assure confidence in the financial integrity of the utility and to maintain the utility's credit rating. This is the principle of financial integrity.

(3) An adequate return is sufficient to enable the utility to obtain necessary capital. This is the principle of capital attraction.

The Commission's task is to balance the interests of the ratepayers and shareholders in the light of the public interest. Mindful of the *Hope* and *Bluefield* principles, the Commission must keep rates as affordable as possible while allowing the Company to earn sufficient revenue to provide safe and adequate service while servicing its debt and attracting necessary capital.

Staff's ROE recommendation of 12.00%, together with Staff's proposed hypothetical capital structure of 65% debt to 35% equity, and Indian Hills' actual cost of long-term debt of 14.00%, best threads the needle by keeping rates as affordable as possible while allowing the Company sufficient revenue to service its debt and continue

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<sup>152</sup> *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

to operate. Staff's rate of return at 13.30% is somewhat less than Indian Hills' cost of debt at 14.00%, and thereby appropriately burdens the shareholders who incurred debt as such unfavorable terms. Nonetheless, 13.30% is sufficient and will yield adequate funds for the Company going forward.

### **III. Conclusion**

**WHEREFORE**, Staff respectfully submits these proposed findings of facts and conclusions of law, and requests the Commission issue an order that:

- A. Adopts Staff's proposed findings and conclusions as a just and reasonable resolution of the issues presented for adjudication;
- B. After adoption of Staff's proposed findings and conclusions, approve and incorporate the terms of the *Non-Unanimous Stipulation and Agreement* into any final Report and Order; and
- C. Grant any further relief the Commission deems just and reasonable.

Respectfully submitted,

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**Attorneys for the Staff of the  
Missouri Public Service Commission**

**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing was served by electronic mail, or First Class United States Postal Mail, postage prepaid, on this 4<sup>th</sup> day of January, 2018, to all counsel of record.

**/s/ Nicole Mers**