BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

APPLICATION FOR REHEARING

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

THE FACTS

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

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

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

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

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

Mr. Cox further admitted that the transactions are complex.

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

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

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

THE LAW

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Commission should reconsider the corporate allocation factor.

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

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

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

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

CONCLUSION

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

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

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

By: /s/ Lera L. Shemwell

Lera L. Shemwell (#43792)
Senior Counsel
Office of the Public Counsel
P.O. Box 2230
Jefferson City Mo65102
(573) 751-5565
(573) 751-5562
lera.shemwell@gmail.gov

CERTIFICATE OF SERVICE

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

/s/ Lera L. Shemwell

(Wherein, return to public session.)

JUDGE BUSHMANN: Back in public session.

BY MS. MAYFIELD:

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

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

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

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

JUDGE BUSHMANN: Do you have copies for the bench?

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

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

BY MS. MAYFIELD:

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

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

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

A. That is correct, ma'am.

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

A. Yes, ma'am.

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

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

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

A. I do.

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

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

A. I do, ma'am.

Q. All right.

A. Sorry. One month off.

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

A. Yes, ma'am.

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

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

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

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

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

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

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

A. Yes, ma'am. It does.
Q. And is that January the 23rd of 2014?
A. Yes, ma'am. It is.
Q. And that was 15 days before your bankruptcy. Correct?
A. Yes, ma'am. It is.
Q. So you would've been filling out your bankruptcy schedules at the same time that you were forming First Round and Central States Water Resources, Incorporated. Correct?
A. Yes, ma'am. I shut my original company down in the summer of 2013.
Q. On Page 6 -- if you would turn to Page 6 of your bankruptcy schedules.
A. Yes, ma'am.
Q. This shows that you took a credit counseling course on December 18th of 2013; isn't that correct?
A. Yes, ma'am.
Q. So you knew you were going to be filing a bankruptcy as early as December 18th of 2013; isn't that right?
A. Yes, ma'am.
Q. Did you advise your bankruptcy counsel that you were working with First Round CSWR and with Central States?

A. Yes, ma'am.

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

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

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

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

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

A. Yes, ma'am.

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

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

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

A. Yes, ma'am.

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

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

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

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

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

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

A. Yes, ma'am.

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

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

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

A. That sounds correct.

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

A. Myself.

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

A. I believe I did.

Q. Would you have gotten that at the same time

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

A. Possibly. I don't remember exactly.

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

A. Yes, ma'am.

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

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

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

A. No, ma'am.

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

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

Q. Would it have been February of 2014?

A. That sounds correct, ma'am.

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

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

A. Yes, ma'am. It does.

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

A. Yes, ma'am.

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

A. That is correct, ma'am.

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

A. I do not recall that.

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

A. My attorney was in charge of all that.

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

A. Yes, ma'am.

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

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

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

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

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

A. Yes, ma'am.

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

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

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

A. No, ma'am.

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

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

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

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

(Off the record.)

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