BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of the tariff filing of Algonquin Water Resources of Missouri, LLC to implement a general rate increase for water and sewer service provided to customers in its Missouri service areas.	)))))	**Case No. WR-2006-0425**

STAFF'S BRIEF

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COMES NOW the Staff of the Missouri Public Service Commission and, for its Brief, states to the Missouri Public Service Commission as follows:

SUMMARY AND OVERVIEW

Algonquin Water Resources of Missouri , LLC ("Algonquin" or "Company") is seeking a rate increase of truly gigantic proportions, considering the number of ratepayers it serves. Algonquin provides water service to three resorts, known as Holiday Hills, Ozark Mountain, and Timber Creek, and it provides sewer service to Ozark Mountain and Timber Creek. The Company serves a total of about 900 customers.

Algonquin is seeking an increase of $736,758 in its water revenues from the three resorts, which amounts to a rate increase of about 269%. The Staff recommends an increase of $114,660 – a very substantial amount, but much smaller than what the Company requests. Algonquin is also seeking an increase of $336,509 in its water revenues from the two resorts it serves, which amounts to an increase of about 241%. The Staff recommends an increase of $115,269 – again, a very substantial increase, but much smaller than the Company requests.

Ascension Resorts ("Ascension") developed the Holiday Hills and Ozark Mountain resorts in the early 1980s. Ascension was not a public utility, but it installed water and sewer facilities at these two resorts and provided service to its resort customers at no charge. About 10 years later, Ascension obtained certificates from the Commission authorizing it to provide water and sewer service to the two resorts. Silverleaf Resorts ("Silverleaf") subsequently acquired the certificates to serve these two resorts. In the late 1990s, Silverleaf developed another resort, Timber Creek, and obtained certificates to provide water and sewer service there.

In 2004, Algonquin acquired Silverleaf's Missouri utility properties, at a cost of $3.8 million. The Staff determined at that time that Silverleaf's rate base was about $1.4 million, and informed Algonquin that it would regard any purchase price above that to constitute an acquisition premium. Algonquin agreed that it would not seek to recover from ratepayers any part of its purchase price that exceeds the rate base of the assets it acquired, as determined by the Commission.

Algonquin claims that its rate base is now $3.8 million, and that there is therefore no acquisition premium. The principal issues in this case involve the determination of Algonquin's rate base. The Company is making the novel and remarkable argument that it should be allowed to include in its rate base the investments that its predecessors made, more than 20 years ago, in utility plant that was not recorded on the books of the company, which it calls "unrecorded plant." This argument is not supported by the evidence in the case, and it runs afoul of the Commission's longstanding policy of basing utility rates on the original cost of the assets when first placed in public service.

Algonquin also claims that its predecessor, Silverleaf, never received any contributions in aid of construction, because Silverleaf failed to comply with the terms of its own tariff. Other issues that affect the value of the Company's rate base are an excess capacity adjustment and an adjustment for construction cost overruns. The Staff informed Algonquin when it acquired Silverleaf's assets that these would be issues in a subsequent rate case.

The other significant issue is the Company's claim to include its rate case expense in the cost of service. The Staff contends that the Company should not be allowed to recover its rate case expense from the ratepayers because the Company imprudently decided not to file a small company rate increase request, as it was permitted to do, but instead filed a full formal rate case. The Staff also contends that the Company filed its rate case prematurely. The Company seeks to recover rate case expense in the total amount of $225,000, which amounts to about $3.79 per customer per month for the next five years.

The Staff will also address in this Brief the viability of the Commission's small company rate increase process. Although the parties did not identify this as an issue in the case, significant questions about the process arose during the evidentiary hearing, and the Staff will address those issues.

In connection with the CIAC issue, the Staff will also address questions about whether the fact that utilities cannot include contributed property in their rate base makes it impossible for them to provide safe and adequate service, as required by law.

ARGUMENT

A. PLANT.

1. What amount, if any, should be reflected as plant-in-service for pre-1993 property?

Algonquin's rate increase request in this case is a thinly veiled attempt to recover from its ratepayers the acquisition premium that it promised it would not seek to recover.

Acquisition Premium. Algonquin agreed in August 2004 to purchase all of Silverleaf's utility assets in Texas, Illinois and Missouri for the total price of $13.2 million. Of this sum, $3.8 million was allocated to the Missouri properties – Holiday Hills, Ozark Mountain, and Timber Creek. Algonquin and Silverleaf then sought the Commission's approval of the asset transfer in Case No. WO-2005-0206 (the "Asset Transfer Case"). In that case, the Staff informed Algonquin that it believed that the rate base value of Silverleaf's Missouri assets was only $1.4 million. Staff made it clear that it considered that Silverleaf had contributions in aid of construction relating to its plant balances. It also indicated in the Asset Transfer Case, primarily for the benefit of Algonquin, that Staff considered there was an over capacity and a construction cost overrun of one of Silverleaf's construction projects. Thus, Algonquin was fully aware of the issues that Staff had discovered during its numerous rate audits of Silverleaf regarding the plant investment Algonquin was acquiring.

When one utility acquires the assets of another utility for more than their rate base value, the difference is called an "acquisition premium." This Commission has never authorized a utility to recover an acquisition premium from its ratepayers, and Algonquin agreed in the Asset Transfer Case that it would not seek to recover from its ratepayers any acquisition premium "as determined by the Commission."

Algonquin has stated, however, that it wants to recover from its ratepayers the full amount of its investment in the assets that it purchased from Silverleaf.[1] It will not be able to do so, however, if the Commission accepts the Staff's determination of rate base

[1] See, for example, Loos Direct, Exh. 1, p. 25, lines 4-12.

value, because there will be an acquisition premium in the amount of about $2.4 million. Thus the only way that Algonquin can recover the full $3.8 million purchase price from its ratepayers is to establish that the rate base is $3.8 million.

Algonquin is using a sort of "back door" approach to try to recover its acquisition premium. Instead of straightforwardly seeking to recover the "acquisition premium," it is trying to eliminate the "acquisition premium" by grossly inflating the Company's rate base, from $1.4 million to $3.8 million.

"Unrecorded Plant." In order to do this, though, Algonquin has had to advance some very creative arguments that have never been seen by – or at least never accepted by – this Commission. Principal among these are the argument that its predecessor, Silverleaf, never received *any* contributions in aid of construction ("CIAC") between 1994 and 2005,[2] and the argument that Algonquin had "paid for" utility plant that Silverleaf had purchased and installed between 1984 and 1993, but which Silverleaf had never properly recorded on its books as a utility asset. Algonquin refers to these latter assets as "unrecorded plant."

The Company's claim that there is unrecorded plant is novel and perhaps unique. The Staff is not aware of any time when this has even been attempted – and Algonquin witness Larry Loos said as much. The Staff is certainly not aware of any time that it has even been approved or endorsed by this Commission, and the Company has cited no case. The Company is asking the Commission to take a truly unprecedented action.

Algonquin bases its claim that there was "unrecorded plant" upon what Mr. Loos describes as a "lack of reported investment prior to 1993." See, for example, the discussion in his Direct Testimony, Exh. 1, at p. 15, line 9 to p. 17, line 7. He repeats this

[2] For a full discussion of the CIAC issue, see Section D of this Brief, at pages 23-27.

conclusion in his Rebuttal Testimony, Exh. 3, p. 16, lines 15-16, stating: "None of this pre 1994 property is included in the Staff balances or Silverleaf balances." And again, in his testimony at the hearing, where he said that he didn't see any evidence that Staff had allowed some pre-1993 property to be included as plant in service.[3]

His statements are unequivocal. But they are wrong.

Staff Included Pre-1993 Plant in Rate Base. The Staff *did* report rate base investment prior to 1993. Staff witness Vesely described in his Direct Testimony the procedure that the Staff followed in determining the value of the Company's rate base.

For the Ozark Mountain service territory, Staff made its first assessment of the Company's rate base in conjunction with Case No. WA-94-246.[4] Mr. Vesely recounted, in detail, how the Staff supplemented its assessment of the rate base at Ozark Mountain in several cases, up to and including the present case.[5]

In like manner, the Staff made its first assessment of the Company's rate base in the Holiday Hills service territory in conjunction with Case No. WA-94-60.[6] Again, Mr. Vesely recounted, in detail, how the Staff supplemented its assessment of the rate base at Holiday Hills in several cases, up to and including the present case.[7]

Mr. Vesely testified that the Staff's work papers in Silverleaf's 1997 small company rate increase case "acknowledged that utility plant had been in service at [Ozark Mountain and Holiday Hills] as far back as 1984, and that they indicate Staff made a thorough review of Silverleaf's investment in utility plant."[8] He reiterated that

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[3] T-43, lines 16-19.
[4] Vesely Direct , Exh. 8, p. 25, line 19 – p. 26, line 7.
[5] Vesely Direct, Exh. 8, p. 26, line 8 – p. 30, line 8.
[6] Vesely Direct , Exh. 8, p. 30, lines 9–20.
[7] Vesely Direct, Exh. 8, p. 31, line 1 – p. 33, line 21 and p. 39, line 12 – p. 40, line 19.
[8] Vesely Direct, Exh. 8, p. 31, lines 7-9.

Silverleaf's rate base was "calculated beginning with the original cost of plant paid when first put into operation providing utility service."[9]

Mr. Vesely again discussed the pre-certificate plant in his Rebuttal Testimony, Exh. 9, lines 4-16, to which he attached, as Schedule 4, copies of signed contracts for water and sewer work at Holiday Hills. The attached documents constituted direct evidence of Silverleaf's pre-1993 utility investments.

In his Surrebuttal Testimony, Mr. Vesely provided further evidence that Staff had properly recognized the investment that Silverleaf had made in its utility plant in 1984, prior to the time that it received its certificate of convenience and necessity. See Vesely Surrebuttal, Exhibit 10, at p. 9, line 18 – p. 10, line 16, where Mr. Vesely specifically itemizes the utility plant items that were included in Staff's initial assessment of Silverleaf's rate base in 1994.[10] See also Sch. GAV 1 to Mr. Vesely's Surrebuttal Testimony, Exh. 10. That schedule shows the calculation of depreciation expense and accumulated depreciation reserve through 1997 for Silverleaf's Holiday Hills and Ozark Mountain service territories. The column headed "1994" shows the total amount of depreciable rate base for each of those service territories during 1994, and it shows that Staff calculated depreciation amounts for the period from 1984 through 1993. This could not have occurred unless the Staff recognized that Silverleaf owned utility plant as far back as 1984, and that this pre-certificate utility plant was included in rate base in 1994.

Obviously, then, Mr. Loos is incorrect to say – as he repeatedly did – that there was no reported investment prior to 1993.

[9] Vesely Direct, Exh. 8, p. 40, lines 12-13.
[10] The items included a $68,500 contract for a water treatment plant and a $69,750 contract for a sewer treatment plant at Holiday Hills, $66,498 for water treatment plant and $68,045 for sewer treatment plant at Ozark Mountain, and $84,082 for water treatment plant at Holiday Hills.

Silverleaf Did Not Object. The question remains whether the amounts that the Staff included were correct. The evidence is that Silverleaf did not dispute Staff's determinations in this regard.

Silverleaf participated in the initial reviews in the 1994 cases and in each of the subsequent reviews. The Commission did not make any formal findings in any of these cases as to the amount of Silverleaf's rate base in any of the Missouri service territories, but Silverleaf did agree upon the rate increases that were implemented on the basis of the Staff's determination of the rate base in each of the service territories. There is no evidence in this case that Silverleaf was dissatisfied with any of these assessments of rate base, and there is no evidence that Silverleaf ever filed a formal rate case or took any other action to challenge the Staff's determination of rate base. If Algonquin believed that Silverleaf was dissatisfied with the results of the rate reviews, it should have produced a witness to so testify. It is reasonable to infer that Silverleaf was satisfied with the Staff's determination.

Staff's Documentation v. Company's Estimates. Staff contends that plant must be valued at the original cost when first placed in service. Any plant not meeting this test is treated as contributed by the developer, at no cost to the utility.[11] The Uniform System of Accounts defines "original cost" as "the cost to the person first devoting it to public service."[12] The person that first devoted the Holiday Hills and Ozark Mountain assets to public service was Silverleaf's predecessor, Ascension Resorts, Ltd., which obtained certificates of convenience and necessity ("CCN") from the Commission in 1994. The original cost of those assets was the cost to Ascension Resorts, regardless of whether

[11] Vesely Rebuttal, Exh. 9, p. 2, lines 1-5.
[12] Vesely Direct, Exh. 8, p. 11, lines 11-14.

Ascension Resorts acquired the assets before or after it received its CCN to serve Holiday Hills and Ozark Mountain. In fact, Ascension Resorts placed many of these assets in service in 1984.

It is Staff's position that any plant investment must be supported with adequate evidence, such as invoices, checks, construction contracts, bids, etc., in order to be included in plant in service.[13] Accordingly, the Staff reviewed purchase orders, invoices, construction estimates and budgets, contracts, letters concerning construction activities, and other related documents to identify the actual costs for the plant-in-service amounts included in rate base.[14]

Company witness Loos, on the other hand, reviewed Silverleaf's records, but did not find evidence of plant in service that was satisfactory to him. He apparently made no effort to contact Silverleaf personnel to obtain better documentation, though, and there is no evidence that he sought information or documentation from the Staff. Instead, he started "supposing" what facilities Ascension must have installed, where the pipes would have been located, how much it would have cost to construct the facilities, and how much the depreciation expense and depreciation reserve ought to be. He relied on a series of estimates, assumptions, virtual designs, trending of costs, etc., because he simply could not find any documentation to support the actual cost that he thought Ascension surely must have incurred.

Mr. Loos testified that there was no question that pre-1993 plant is providing service today, but that there is simply no paper trail,[15] so he relied upon estimates. He acknowledged the Commission generally uses documented costs to establish rate base,

[13] Vesely Rebuttal, Exh. 9, p. 2, lines 1-5.
[14] Vesely Direct, p. 11, lines 3-7.
[15] T-100, lines 10-20.

and he did not recall any occasion in the 93-year history of the Commission that the Commission had established the rate base of any utility asset on the basis of estimates. [16] Nonetheless, he wants the Commission to rely on estimates, and he wants the ratepayers to pay on the basis of estimated costs.[17]

But the Staff did find a paper trail and relied upon actual documentary evidence to determine the proper amount to include in rate base.

The Burden of Proof. Section 393.150.2, RSMo provides, in part, as follows: "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the … water corporation or sewer corporation …" The Commission certainly cannot find, with any degree of confidence, that Mr. Loos' estimates and virtual designs serve as an accurate measure of rate base.

If the principle of imposing the burden of proof upon the utility, as required by statute, is to have any meaning at all, the Commission must find that the Company's estimates fail to meet that burden.

Developers' Contributions. The Commission has historically required the regulated utility companies to provide the central water and sewer facilities (wells and water and sewer treatment plants) and developers to contribute mains and collecting sewers. That is because the extension of mains and sewers is a development risk, which should be borne by the developer, not by the utility. The developer is engaged in activities driven by a profit motive, and must have the knowledge to bear the risks of its

[16] T-61, line 11 – T-62, line 1.
[17] T-61, line 1 – T-61, line 10.

chosen endeavor. None of those risks should be transferred to the utility, or its existing or future customers, so as to subsidize the developer's business.

Although the developer must initially contribute the mains and sewers to the utility in most cases, the developer is able to eventually recover these costs from its customers. Generally, the business of a developer is to buy land, make certain improvements to it, such as clearing the land, subdividing, constructing streets and curbing, installing utilities, etc., and then sell, lease or rent it to its customers at a profit. One of the costs it must recoup is the cost of the mains and sewers that it has paid for.

Silverleaf's predecessor, Ascension Resorts operated the resorts at Holiday Hills and Ozark Mountain from 1984 to 1993. It was not then authorized to sell water and sewer service, but it was in business to make a profit. The only way it could recover its investment in the mains and collecting sewers was by including this cost in the price of the lots it sold. Accordingly, it has already recovered this investment from its customers.

Customers Should Not Pay Twice for the Same Facilities. The ratepayers in the Holiday Hills and Ozark Mountain service territories have already paid for these facilities once. They should not have to pay for them again. But that is what will happen if the cost of these facilities is included in Algonquin's rate base and is passed along to Algonquin's ratepayers again.

The Commission should not worry that Silverleaf (or its predecessor) may have twice recovered its costs. It is true that Silverleaf (or its predecessor) has already recovered the cost of these facilities once, as noted above. And it is possible that Algonquin paid an unreasonably high price to Silverleaf for the purchase of its assets. But that does not mean that the Commission should seek to punish Silverleaf, by permitting Algonquin to require Silverleaf to again pay for the water mains and collecting sewers.

The agreement between Silverleaf and Algonquin was an arm's length negotiation. If Algonquin paid too much, then it has suffered and Silverleaf has benefited. That is what sometimes happens in the marketplace, when one party makes a wise decision and the other party makes an unwise decision. But if the Commission approves Algonquin's request in this case, customers will have to pay twice – not because they made an unwise decision, but because they are the captive customers of Algonquin, whose rates are set by the Commission. The Commission should not try to right the wrong of Algonquin paying too much for Silverleaf's assets, but should steadfastly insist that customers not pay again for something they have already paid for.

Furthermore, it is virtually certain that Silverleaf will not shoulder the burden of Algonquin's water and sewer rates, but will pass them along to their customers. Since Silverleaf is a resort operator, its customers tend to be transient (albeit well-heeled), and they are therefore not well-organized. Still, they are entitled to just and reasonable rates, and should not be compelled to pay again for facilities that Silverleaf's customers have already paid for once before.

Algonquin Did Not Pay for "Unrecorded Plant." Finally, Algonquin witness Loos repeatedly stressed that Algonquin acquired "all of the utility property" of Silverleaf in Missouri.[18] Staff contends, though, that Algonquin did not "pay for" the "unrecorded plant," because it did not even know this "unrecorded plant" existed until Mr. Loos told them about it in December 2005 – 16 months after it signed the contract with Silverleaf,

[18] Loos Direct, Exh. 1, p. 15, lines 4-6. See also Loos Direct, Exh. 1, p. 17, lines 11-12.

and four months after the transaction closed. Algonquin did not bargain for the "unrecorded plant"; rather, it bargained for Silverleaf's regulatory rate base.

An analogy will serve to illustrate the point. A person who buys an old painting at a garage sale for $50, but later finds that there is an original Van Gogh underneath it did not "pay for" the Van Gogh, even though he does surely own it after the sale. Even though Algonquin does surely own all of Silverleaf's utility assets in Missouri, it did not "pay for" the "unrecorded plant," of which it did not even have any knowledge until 16 months after it signed the contract. Algonquin will not lose the benefit of its bargain if the Commission does not allow it to include the "unrecorded plant" in its rate base.

<u>*Total Pre-1993 Plant in Service.*</u> According to work papers prepared and maintained by the Staff, the total amount of plant in service that was installed prior to 1993 is $543,245. It is important to note that this is not a rate base value, but is the total pre-1993 plant in service, without any deduction for depreciation or contributions in aid of construction.

2. What is the appropriate level of post-1992 plant that should be included as plant-in-service?

The Staff's calculation of the *total* amount of plant in service is shown on the EMS runs that the Staff filed in this case as Exhibit 28. The Staff prepared an EMS run for each of Algonquin's five facilities. The *total* plant in service at each facility is shown on Line 1 of Schedule 2 of each of these EMS runs. The amounts are as follows: Holiday Hills (water) -- $1,546,304; Ozark Mountain (water) -- $342,956; Ozark Mountain (sewer) -- $410,972; Timber Creek (water) -- $865,779; and Timber Creek (sewer) -- $786,512. The *total* plant in service is therefore $3,962,523.

It is important to note, however, that this *total* plant in service includes both pre-1993 plant and post-1992 plant. Since the pre-1993 plant in service is $543,235, the amount of post-1992 plant in service is $3,409,288.

B. EXCESS CAPACITY. Do Algonquin's facilities include plant held for future use, which should not be included in plant in service, because they include excess capacity? If so, what is the value of the facilities that should not be included as plant-in-service?

Silverleaf constructed the water and sewer systems at Holiday Hills, Ozark Mountain, and Timber Creek, as a developer, in order to promote its resort business. In doing so, it constructed water systems that were larger than were initially needed, which essentially amounted to plant held for use at such time as the resorts were fully developed. As a developer, Silverleaf took the risk of constructing systems that were not yet needed.

There is no excess capacity in the sewer systems at these three resorts. However the Ozark Mountain and Timber Creek resorts have not developed as fast as Silverleaf planned, so the water systems there have excess capacity. The Holiday Hills resort has been fully developed, but Silverleaf made more additions to the water facilities there than were needed, and there is excess capacity there also.

Silverleaf was willing to shoulder the risks associated with having excess capacity. But the Staff does not believe it is appropriate for the ratepayers to pay for this excess capacity, which was not installed for their benefit, but rather for Silverleaf's benefit, to promote the development of the resorts.

The Staff warned Algonquin, during the Sale Case, that it would adjust its evaluation of the rate base, to reflect the fact that the facilities have excess capacity. By its agreement to buy these utility systems, despite the Staff's warning, Algonquin assumed the risk that it would not be able to include the excess capacity of the water facilities in its rate base immediately. Consistent with its recommendation in the Sale Case, the Staff now recommends that Algonquin's rate base be adjusted to account for the excess capacity.

As this case progressed toward hearing, several of the excess capacity issues have been resolved. These include the calculation of the peak day and peak hour demand and the accuracy of the flow meters used. The Staff also agrees with the Company that 1,500 gallons per minute for two hours is a reasonable desired fire protection level. Consequently, the amounts of the claimed excess capacity adjustments have been reduced; however a dispute still remains. The Staff recommends the following adjustments to rate base.

Holiday Hills: Ninety-one percent of the storage tank capacity is used and useful, so there should be a nine percent adjustment to rate base for this item.

Ozark Mountain: This system has neither the storage capacity nor the high-service pump horsepower to provide the necessary fire flow, and there may not be an adequate number of hydrants in the service area, so fire protection volume is probably only about 800 to 900 gpm. The Staff recommends a 68% adjustment to the rate base amount for storage capacity at Ozark Mountain.

Timber Creek: This system has sufficient storage volume to provide 1,500 gpm to a fire, but may not have sufficient high-service pumping horsepower for this flow. The

Staff recommends a 28% adjustment to the rate base amount for storage capacity at Timber Creek.

Value of the Excess Capacity Adjustment. The Staff modified its position on the amount of the excess capacity adjustment during the proceedings in this case. After taking into account the changes discussed above, the values of the excess capacity adjustments are as follows: Holiday Hills (water) -- $27,846; Ozark Mountain (water) -- $19,318; and Timber Creek (water) -- $156,039.

C. CONSTRUCTION COST OVERRUN. Were some of the costs of constructing the facilities imprudently incurred? If so, how much should the plant-in-service accounts be reduced?

The key question in resolving this issue is: Was Silverleaf's decision to terminate the contract with Larry Snyder & Company ("LSC") and execute a new contract with Construction Management Specialists ("CMS") prudent? That is: was the decision to replace LSC with CMS substantially justified?

It is undisputed that this decision resulted in a substantial increase in the cost of the Holiday Hills Well No. 2 project. And while Silverleaf may have had the right to terminate that contract, the increased cost should only be passed along to the ratepayers if the decision was prudent.

Algonquin's only evidence on this point is the testimony of Charles Hernandez. But Mr. Hernandez did not work for Silverleaf, and he was not involved in the construction of the Well No. 2 project. His testimony is, therefore, totally based upon conversations that he had with Michael J. Brown and the testimony that Mr. Brown filed in another case before the Commission.

Although Mr. Brown's testimony was clearly hearsay, the Commission allowed this testimony to be admitted into evidence over the objection of the Staff. The fact that the testimony was admitted does not, however, mean that it must all be accepted. The Commission can consider the testimony "for what it's worth." For the reasons that are set forth below, the testimony is not worth much, and the Commission should give very little weight to the testimony of Mr. Brown.

Mr. Brown prefiled the subject testimony as surrebuttal testimony in Case No. WO-2005-0206. That case was settled before hearing, however, and Mr. Brown never had to actually testify, and the Staff never had an opportunity to cross-examine him, or to test the veracity and relevance of his statements. Furthermore, because his testimony was surrebuttal, the Staff never had an opportunity to submit or present any testimony in response to Mr. Brown's testimony. And because the testimony was filed so late in the proceedings in Case No. WO-2005-0206, the Staff was not able to submit any data requests or conduct any other discovery concerning Mr. Brown's testimony. Testimony such as this may be admitted for the purpose of showing that the statements were made; but that was not Algonquin's purpose in offering this testimony. Algonquin offered the testimony as evidence of the truth of the matters alleged, and it is therefore hearsay. Mr. Brown's testimony has all of the shortcomings of hearsay, and the Commission should give it no weight whatsoever in determining the truth of the matters alleged.

The testimony of Mr. Hernandez, in turn, depends almost entirely upon the statements of Mr. Brown. He has, to a large extent, actually copied the testimony of Mr. Brown; see, e.g., the question and answer at page 3, lines 7-13, which repeats the testimony of Mr. Brown verbatim.

Mr. Hernandez acknowledged that he had no first-hand knowledge of the Holiday Hills Well No. 2 project. Rather, he relied entirely upon statements that Mr. Brown made to him. Such testimony is hearsay, and should be given little or no weight.

Mr. Hernandez justifies Silverleaf's actions by telling how an owner may deal with a "failing contractor." He refers at least three times to LSC as a "failing contractor," as though this were an established fact. Actually, there is no evidence that LSC failed or was failing. Even a review of the surrebuttal of Mr. Brown does not indicate such failure on the part of LSC. Mr. Henandez offered no such evidence; Mr. Brown did not testify that LSC was failing; and Mr. Vesely said that to his knowledge LSC did not fail.

Based upon the totally unsupported premise that LSC was a "failing contractor," Mr. Hernandez then tells what failing contractors have been known to do, in his experience. He said they demand change orders, or cut corners on the construction of a project. One must understand that he is talking, now, about contractors in general, and not about LSC in particular. His logic approximates the following syllogism: Failing contractors sometimes cut corners; LSC was a failing contractor; therefore, LSC would probably have cut some corners. But the syllogism fails, because, as noted above, there is no evidence that LSC was a "failing contractor." Mr. Hernandez has also committed the logical fallacy of a hasty generalization. He assumes that because some members of a class (contractors) behave a certain way (they sometimes cut corners), then all members of the class (including LSC) will behave the same way. These arguments are fallacious, and the Commission should reject them.

Mr. Hernandez also states or implies that LSC was generating an excessive number of change orders on the Well No. 2 project. That statement is simply untrue. Mr.

Vesely testified that Change Order No. 1 was issued on November 7, 2000, and that to his knowledge, there were no other change orders. Furthermore, it was Silverleaf, not LSC, that requested Change Order No. 1. Silverleaf changed the description of the project and the scope of the work, and asked LSC how much extra they would need to be paid for this changed work. LSC proposed to do this extra work for $31,209 and Silverleaf accepted. This change order was not the fault of LSC. No witness testified that there were any other change orders on the Well No. 2 project during the time that LSC served as the general contractor.

Even Mr. Brown did not claim that LSC had requested an inordinate amount of change orders on the Well No. 2 project. Rather, he testified that LSC was generating excessive change orders on other projects, and that Silverleaf therefore terminated the contract with LSC for the Well No. 2 project.

Although Silverleaf may have been within its rights to terminate the contract with LSC, and to pay something extra to another contractor for the same work, that does not mean the extra costs associated with this change were prudently incurred, and the Commission should not require the ratepayers to pay this extra cost. It therefore becomes necessary to calculate the extra cost that resulted from the change of contractors.

The elements of this adjustment are set forth on page 35 of Mr. Vesely's Direct Testimony. The facts that support this adjustment are as follows.

Silverleaf signed a contract with LSC, by which it agreed to pay $339,058 for the project as described in the original plans and specifications. LSC began performance of the contract by delivering a large amount of material to the construction site and performing some construction work, but the parties then terminated the contract.

Silverleaf paid LSC $153,412 for the work that LSC did before the contract was terminated.

Silverleaf then contracted with CMS to complete the project. CMS had originally bid $421,900 to perform the contract as originally designed, but since they were able to use the materials and work that LSC had provided, they reduced this bid by $106,119.94 (for materials) and by an additional $5,000 for work performed.

By terminating the contract with LSC and entering into a new agreement with CMS, the Company increased its construction cost by about $82,000 (the difference between the low and the second low bids.) In addition, by paying LSC $153,412, for the work that it had done, but only receiving a credit of $111,119.94 from CMS, the construction cost increased by about another $42,000.

It is important to understand that these two elements of the cost overrun are do not result in double-counting. If the original bids had been equal, and the credit given was still as it was, then the second part of the disallowance would still apply. But the original bids were not equal, so by going to the second contractor, the Company had to pay another $82,000 on the contract price.

The third part of Mr. Vesely's adjustment results from the fact that the Company had to pay interest for a much longer time, because the project took so long to complete.

Value of the Construction Cost Overrun Adjustment. In his Direct Testimony (Exh. 8), Staff witness Vesely testified that the total value of this adjustment is $186,373. However, at the evidentiary hearing, under questioning by Commissioner Murray, Mr. Vesely agreed to reduce the amount of this adjustment by $25,624. The resulting net adjustment is $161,749.

D. CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC). What is the amount of contributions in aid of construction that should be used to reduce Algonquin's plant-in-service accounts?

The Staff contends that Algonquin's plant-in-service accounts should be reduced by about $500,000 for contributions in aid of construction.

It's important to understand that this issue has nothing to do with assets that were first placed in service prior to July 1, 1994, when Silverleaf's predecessor (Ascension Resorts) obtained its certificates of convenience and necessity in Case No. WA-94-60 and Case No. WA-94-246. The CIAC issue pertains *only* to assets that were placed in service since that time. *Some* of the assets placed in service since July 1, 1994 should have been contributed by the developer – either Silverleaf or its predecessor, Ascension Resorts.

In a nutshell, the issue with regard to CIAC is this: Where Silverleaf's tariff required Silverleaf (the developer) to contribute plant to Silverleaf (the utility), but Silverleaf (the utility) failed to enforce its tariff, should the plant be treated as CIAC for rate-making purposes?

Rule 14 of Silverleaf's water tariff governed the extension of water mains in Silverleaf's certificated area. It provided that when water mains were to be extended to serve a customer, such as Silverleaf (the developer), the customer must either construct or pay for the construction of the water mains, which would then become the property of Silverleaf (the utility). The rule also specified the procedure to follow in making such extensions.[19]

[19] The relevant portions of Rule 14 of Silverleaf's water tariff were reprinted in Mr. Vesely's Direct Testimony, Exh. 8,. p. 17, lines 9-29. Immaterial portions of Rule 14 were not reprinted in Mr. Vesely's

Rule 11 of Silverleaf's sewer tariff governed the extension of collecting sewers in Silverleaf's certificated area. It provided that when collecting sewers were to be extended to serve a customer, such as Silverleaf (the developer), the customer must either construct or pay for the construction of the collecting sewers, which would then become the property of Silverleaf (the utility). The rule also specified the procedure to follow in making such extensions.[20]

These tariffs were binding upon Silverleaf (the utility); but Silverleaf failed to comply with the terms of its own tariffs.

Algonquin now contends that, because Silverleaf failed to comply with its own tariffs, the water mains and collecting sewers did not become CIAC. It also contends that since the mains and sewers did not become CIAC, they must necessarily be included in rate base. And, Algonquin argues, if it is included in rate base, then Algonquin can recover the cost of this plant from its ratepayers.

Thus, Algonquin argues that because Silverleaf (the utility) failed to do what it was obliged to do, Algonquin must be allowed to recover from ratepayers the cost of this plant, which Silverleaf (the developer) should have contributed at its own cost and at no cost to the ratepayers.

There is a well-established legal maxim that a person must not be allowed to benefit from his own wrongdoing. The Commission should not allow Silverleaf, or its successor, Algonquin, to benefit from its own misfeasance.

Direct Testimony; however no party has contended that the portion that Mr. Vesely included in his Direct Testimony was misleading in any way.

[20] The relevant portions of Rule 11 of Silverleaf's sewer tariff were reprinted in Mr. Vesely's Direct Testimony, Exh. 8, at p. 18, line 1 – p. 19, line 3. Immaterial portions of Rule 14 were not reprinted in Mr. Vesely's tariff. Where material was omitted, ellipses were substituted for the omitted material. No party has contended that the portion that Mr. Vesely included in his Direct Testimony was misleading in any way.

There should not now be any argument about what Silverleaf *should* have done. Its obligations are clearly spelled out in the tariffs. This is not a question of policy or judgment, and it is not something that can be changed or excused. In the matters that the Commission regulates, there is hardly any authority that is higher than a tariff. Tariffs are *law*, and they must be complied with.

The fact that Silverleaf (the utility) failed to do what it was supposed to do, and enforce its tariffs, does not give Silverleaf (the utility) a free pass to make ratepayers pay for property that should have been contributed by Silverleaf (the developer). Nor should Algonquin get a free pass. It would be just as wrong for the Commission to allow Silverleaf (the utility) to convey to Algonquin the illegal power to make ratepayers pay for property that should have been contributed by Silverleaf (the developer).

The suggestion, raised at the hearing for the first time, that CIAC ought to be included in rate base, in order to allow regulated utilities to earn a greater return, and thus generate additional cash flow, is misplaced, for several reasons, which are set forth in the following paragraphs.

First, Algonquin is not a company that is at risk of having inadequate rate base. If the Commission adopts all of the Staff's recommendations and requires Algonquin to record CIAC in the amount of about $500,000, Algonquin will still have a rate base of about $1.3 million. The hypothetical questions about companies that have zero rate base simply have no foundation in the facts of this case. Algonquin would have a rate base of almost $1,500 per customer for each of its 900 or so customers, even if it is (properly) ordered to identify this plant as CIAC.[21]

[21] $1,300,000 divided by 900 customers.

Second, even Algonquin does not contend in this case that CIAC should be included in rate base. Rather, Algonquin simply contends that there *is no CIAC,* because its predecessor, Silverleaf, neglected to enforce its own tariffs.

Third, there is no evidence that the small companies in this state who are "hemorrhaging" have been harmed by the Commission's longstanding policy, and the tariffs, that require customers to make contributions in aid of construction. Questions were raised at the hearing about why some small water and sewer companies have gone into receivership or bankruptcy,;but there was not any testimony that CIAC has caused any of these problems.

Hickory Hills Water and Sewer Company, for example, did not go into receivership because it had no rate base. The reason that the owners of Hickory Hills gave up on the company was that they could not get satisfactory compensation for the time they devoted to their utility or for their mileage expense, and because they had to incur substantial legal expense for representation at an evidentiary hearing, when they only trying to pursue an informal small company rate increase case without counsel in Case No. WR-2006-0250.

Fourth, there is no policy reason why a utility should receive a return on rate base when it has not invested any money in the rate base. The only reason that the Commission allows a return on rate base is because the utility has invested money. In another context, an investor has a right to expect interest on the money that he deposits in a bank or savings and loan; but he has no right to expect interest if he has not deposited any money. Likewise, a utility has a right to expect a return of, perhaps $8,000, if it has invested $100,000 in its plant; but in order to earn this return, it must somehow come up with the $100,000 to invest. The utility is not placed at a disadvantage if a customer provides the $100,000 that is needed and the utility therefore receives no return.

It is important to note that the return on rate base is not the only way that the owner of a utility can realize any income from the utility. As one example, the utility's customer base may grow, so that, for a time at least, the revenues from the expanded customer base exceed the expenses. Or the mere existence of the utility (and the availability of utility services) may increase the profitability of the owner's other business interests, such as the development of the subdivision that the utility serves. Or the owner may improve the efficiency of the utility, to make it more profitable. And the owners may also receive compensation for the services they provide to the utility.

The ability to receive compensation from the utility is not insignificant. For the vast majority of American workers, compensation for services is the only source of income from their work – or it is at least the dominant one. An employee of the Commission, for example, may find the terms of his employment to be completely satisfactory, even though he receives only a salary, and no "return on rate base." The employee understands that even though someone else (the Commission) has provided office space, furniture, and equipment, such as a computer, there is no reason why the employee should receive a return on this investment by others. Likewise, the owner of a utility who is adequately compensated for services does not need to have an investment in the facilities he uses, if he has made no investment in them.

Value of the CIAC Adjustment. The gross value of the CIAC issue, without making any allowance for depreciation is $1.2 million for water facilities and $353,000 for sewer facilities. The net CIAC, after deducting depreciation, is a total of $1.2 million.

E. DEPRECIATION RATES. What depreciation rates should be applied to the various elements of Algonquin's plant in service?

Staff recommends that the Commission adopt the depreciation rates and service lives as set forth in Schedule 2 attached to the Direct Testimony of Rosella Schad, Engineer for the Missouri Public Service Commission (Exh. 20). Staff believes those depreciation rates are fair and represent reasonable standards for the industry. Staff applied standard service lives to plant in service, to determine depreciation rates.

Algonquin, for the most part, agrees with Staff's depreciation rates. The depreciation rates proposed by Algonquin, as evidenced in Schedule LWL-3 sheet 2 attached to Mr. Loos's Direct Testimony (Exh. 1), differ from Staff's in nine different areas: for the water utility Algonquin proposes changes to Staff's recommendations in the area of Well Pump—Electric Pump Equipment, Computer Equipment and Software, and Office Furniture and Equipment; on the sewer utility Algonquin proposes changes for Receiving Wells, Pumping Equipment, Computer Equipment and Software, Office Furniture and Equipment, Sewer Plant, and Sew System Dev—Engineering.

When asked about the differences between Staff's proposed depreciation rates and Algonquin's proposed depreciation rates, Mr. Loos testified that the depreciation numbers proposed by Staff were changed to achieve a lower reserve ratio.[22] The reserve ratio is subtracted from plant invested to determine the rate base, and as the reserve ratio decreases, then the rate base increases.[23] By increasing the rate base, Algonquin would

[22] T-353, lines 8-15.
[23] T-351, line. 10 – T-351, line 2.

have a higher base upon which to earn a higher return.[24] To lower the reserve ratio, Mr. Loos changed the service lives of the nine different items enumerated above.

However, changing the service lives of plant is not the proper method of changing the reserve ratio. The useful life of plant does not change. Increasing the service lives of the different assets does not mean that the asset will indeed have that long of a useful life. In Mr. Loos's Schedule LWL-3, he changed the service lives of Office Equipment and Furniture, and Computer Equipment and Software from 20 and 6.99, respectively, to 40 and 18.18, respectively. Even Mr. Loos agrees, however, that expecting office furniture to have a useful life of 40 years, and computer equipment and software to have a useful life of 18.18 years, is unreasonable.[25]

Mr. Loos indicated that the reserve ratio under Staff's proposal would be 120 percent, which he believes is too high. So, to lower the reserve ratio to a more acceptable number, he lowered the overall depreciation rate to 5.5 percent, which required the service lives of some plant to be changed.[26] As mentioned above though, service lives do not change. Changing the service life of computer equipment and software to 18.18 years on paper does not mean that computer equipment is actually going to have a useful life of 18.18 years. More likely, computer equipment and software will be obsolete by the end of Staff's proposed service life of 6.99 years. Staff's proposed service life of 6.99 years for Computer Equipment is a normal approximation for a small company.[27]

Furthermore, the service life of an asset is the first thing to consider when calculating depreciation rates. The useful life of the asset is calculated, and then, given

[24] T-358, lines 1-5.
[25] T-353, lines 3-5, and T-354, lines 3-5.
[26] T-353, lines 8-12.
[27] T-367, lines 20-25.

whatever the net salvage percentage is, the actual depreciation rate is established.[28] Changing the service lives of plant just to lower the depreciation rates is the wrong way to determine the appropriate depreciation rates.

Staff believes that the high reserve ratios accompanying Algonquin's proposed depreciation schedule are a result of plant that is out of service, but has not been retired off the books. Mr. Loos himself admitted that the large reserve ratio that is inherent in Staff's proposed depreciation schedule might mean that Algonquin needs to start planning to retire some equipment.[29] Staff witness Schad testified that if Algonquin retired off the books the plant that had actually been physically retired, then the reserve ratio would come down, and would not be as high as indicated in Staff's proposed depreciation schedules.[30]

As an example of plant no longer in service which had not been retired from the books, Ms. Schad indicated that in talks with Algonquin, Staff discovered that the previous owner of the utilities had bought new computers in 2004 and those computers had already been taken out of service when Algonquin took over the utilities.[31] However, even though the computers had been taken out of service, they had not been retired from the books.[32]

To reiterate, Staff argues that the depreciation rates shown in Schedule 2-1 of Ms. Schad's Direct Testimony,[33] are the depreciation rates that should be used when calculating rate base in the current case. Algonquin has proposed several changes to

[28] T-368, lines 2-5.
[29] T-358, lines 20-25.
[30] T-366, lines 2-17.
[31] T-366, lines 12-17.
[32] T-366, lines 12-17.
[33] Exh. 20.

those rates set out in Schad's Schedule 2-1, which Staff believes are improper, because service lives were adjusted to achieve Algonquin's desired reserve ratios. The reserve ratios inherent in Staff's proposed schedule are the result of plant that has been physically retired, but not retired off the books.

F. CAPITAL STRUCTURE. What capital structure should the Commission apply to Algonquin's investment in determining the proper rate of return on Algonquin's rate base?

Mr. Loos initially recommended a capital structure consisting of 70.72% equity, based on the capital structure of Algonquin's parent company as of December 31, 2004. He subsequently amended that figure to 65.18% equity, based on the capital structure as of December 31, 2005. He again amended it downward to 58.21% equity, based on the capital structure as of September 30, 2006.[34]

Mr. Barnes believes that this capital structure is inappropriate, because Algonquin's parent is a Canadian company, which is not organized like a typical publicly traded U.S. water utility corporation, but is organized to distribute a majority of its free cash flow to its shareholders.[35] The Commission needs to determine what returns are generally being made in this part of the country by companies with risks and uncertainties that are similar to those that Algonquin will face when it delivers services to its customers in Missouri.[36]

It is therefore more appropriate to use the capital structure of a group of comparable United States companies. Mr. Barnes recommends a capital structure based

[34] T-378, line 16 – T-380, line 16.
[35] Barnes Rebuttal, Exh. 12, p. 3, lines 20-23.
[36] Barnes Surrebuttal, Exh. 13, p. 3, lines 18-20.

on a selection of comparable companies as of December 31, 2005, consisting of 47.88% equity and 52.12% long-term debt.[37]

G. RETURN ON EQUITY. What return on equity should the Commission apply to Algonquin's investment in determining the proper rate of return on Algonquin's rate base?

The guidance provided by recent decisions of the Commission. Determining the proper rate of return for a regulated utility is often the most important issue in a case, and it is always a difficult issue. Although it involves science and the application of equations, it is often more "art" than "science." As the Commission has twice observed in recent cases: "Determining an appropriate return on equity is without a doubt the most difficult part of determining the rate of return."

The Commission's view on how to determine the proper return on equity ("ROE") has evolved in recent years. The Staff will therefore look to the most recent Commission decisions for guidance on how to perform this crucial task. A review of those decisions reveals that the most important factors are: the identification of a "zone of reasonableness"; the qualifications and credentials of the testifying experts; the number and selection of the "comparable companies'; compliance with the standards announced in the *Hope* and *Bluefield* cases; and the methodology used.

In the KCPL case, for example, the Commission first established a 200-basis-point "zone of reasonableness," which ranged from 100 basis points below the "average allowed return in the electric utility industry" in the relevant period to 100 basis points above that average. It then eliminated one expert, because the ROE he recommended did

[37] Barnes Direct, Exh. 11, p. 11, lines 16-18, and p. 12, lines 11-13.

not fall within this "zone of reasonableness."[38] The Commission next eliminated the Staff's expert, because he used a small number of "comparable companies," and because he decided not to allow for construction risk when calculating return on equity. Finally, the Commission eliminated the OPC expert, because he gave vague answers to some questions about his methodology. This left only the KCPL expert, and the Commission accepted his ROE recommendation, because he had excellent credentials and qualifications, he used a large number of comparable companies who satisfied the requirements of *Hope* and *Bluefield,* and the Commission approved of his methodology.

The Commission initially introduced the concept of the "zone of reasonableness" in the Missouri Gas Energy case. The Commission found that the "average allowed return in the gas utility industry" during the most relevant period was 11%. MGE's expert recommended an ROE of 12%. The Commission found that since MGE believed an ROE that was 100 basis points above the industry average would be reasonable, then an ROE that was 100 basis points below the industry average would also be reasonable. The Commission decided that the "zone of reasonableness" was from 100 basis points below the industry average to 100 basis points above the industry average. This was apparently the genesis for the Commission's subsequent selection of a 200 basis point "zone of reasonableness" in the KCPL case. In the MGE case, the Commission selected an ROE at the bottom of this zone, added a 50 basis point adjustment, and then explained how the result (10.5%) was supported by the evidence in the case.

[38] The Commission did not, however, eliminate the KCPL expert, even though he recommended an ROE that was above the top end of the "zone of reasonableness," because his recommendation included an "adder," which, the Commission said, should not be considered when determining whether the recommendation was within the "zone of reasonableness."

In the most recent Empire District Electric Company rate case, the Commission again established a 200-basis-point "zone of reasonableness." It found that the recommendations of all three of the testifying experts fell within this "zone of reasonableness"; but it also found that none of the experts' final results appeared to be reasonable. The Report and Order did not place great emphasis on the qualifications of the experts, but it did say that the Staff's sample group of five companies was "simply too small to perform a credible analysis in this scenario." The Commission found that the "national average ROE"[39] was between 10.55% and 10.57% during the relevant time period. It also apparently relied primarily on Empire's witness to find that the comparable companies' average ROE was at or near 10.9%. It appears that this latter figure was neither allowed nor realized, but was "market-determined." Although the Commission stated that *Hope* and *Bluefield* require a "comparative method," it established Empire's allowed ROE at the "market-determined" rate of 10.9%.

The "zone of reasonableness" Based upon the foregoing analysis, the Staff seeks first to determine the "zone of reasonableness" for Algonquin. Two experts testified in this case: Larry W. Loos, for Algonquin, and Matthew Barnes for the Staff. Neither witness provided any testimony regarding the industry average return on equity for the regulated water or sewer industry. There was simply no evidence, whatsoever, on this subject. It is therefore impossible to determine the "zone of reasonableness" that the Commission has referred to in the MGE, KCPL and Empire rate case decisions discussed above.

[39] The Report and Order did not state the source of this information or tell whether it represented the allowed ROE or the realized ROE. It is reasonable to infer that this was an ROE for the regulated electric industry.

This does not terminate the Commission's analysis of this issue; it merely means that the analysis must continue without reference to a "zone of reasonableness." Either of the expert witnesses could have furnished testimony about the industry average ROE. However, as the applicant, Algonquin has the burden of proof in this case. Any failure of proof regarding the "zone of reasonableness" must therefore be attributed to Algonquin.

Credentials and qualifications of the experts. The Company's expert witness, Mr. Loos, is an engineer. He has a bachelor's degree in mechanical engineering, he has worked for an engineering firm continuously since 1971, and he belongs to five professional organizations, each of which relates to the field of engineering or depreciation. He has testified extensively before utility commissions in many jurisdictions, primarily on engineering and depreciation issues.

Mr. Loos also has a master's degree in business administration, but he acknowledged that this education did not emphasize financial analysis, and he testified, vaguely, that he only took one or two classes in financial analysis. Mr. Loos has only testified as an expert on the ROE issue about five times. In each of those five cases, he also testified on other issues, and he has never testified primarily on the issue of ROE. Although Mr. Loos has testified extensively in utility regulation cases, most of this experience has involved gas or electric utility regulation; he has only testified a few times in cases involving water or sewer companies.

Unlike the expert witnesses for MGE, KCPL and Empire, discussed above, Mr. Loos has never taught classes on the subject of financial analysis. Nor has he published any articles on the subject. Mr. Loos's methods of financial analysis have not been subjected to peer review, and no commission has endorsed any of these methods.

Furthermore, in his testimony in this case, Mr. Loos did not cite a single treatise or authoritative source on which he relied in developing his methods of analysis for this case. Nor did he cite or discuss the *Hope* and *Bluefield* cases, or how they should be applied in this case, or any other legal precedents or decisions by this Commission or by any other utility commission.

The Staff's expert witness, Mr. Barnes, received a bachelor's degree with an emphasis in accounting in 2002 and a master's degree in business administration with an emphasis in accounting in 2005. He is a financial analyst by profession, and he has been employed by the Commission as a full-time utility regulatory auditor since 2003. Mr. Barnes has participated in four recent rates cases before this Commission, and has filed testimony on rate of return and other financial issues is several other recent cases before this Commission.

Although Mr. Barnes has fewer years of total experience, his experience in the field of financial analysis exceeds that of Mr. Loos.

Mr. Barnes also discussed the requirements of the *Hope* and *Bluefield* cases, and other legal precedents, to apply their principles to the determination of the proper ROE for Algonquin. In addition, he cited and relied upon learned treatises and the decisions of other commissions in recent rate cases.

Undaunted by the facts that he only took a couple of classes on the subject of financial analysis, has never taught the subject, seldom testifies on the ROE issue, and seldom testifies in water and sewer cases, Mr. Loos nonetheless analyzed Algonquin's ROE requirement with a technique of his own devising. He has never written articles about his approach, it has not been reviewed by his peers, and, to the best of his knowledge, no one else utilizes it. The Commission should study it carefully and critically.

Mr. Loos basically uses the DCF approach, the same as Mr. Barnes, but with a few modifications. Most notable among these are that: he utilizes book value when calculating Algonquin's yield; after assembling data on his comparable companies, he chooses the DCF for his comparable companies "by inspection"; he does not test the results of his DCF analysis for reasonableness, by comparing the DCF results with the results of other methods of analysis; and he increases his recommended ROE without sufficient quantification or justification.

In his discussion of the DCF model, Mr. Loos states the following:

> The theory suggests that when an investor buys a stock, the investor expects a return derived from cash flows received in the form of dividends plus appreciation in market price (the expected growth rate). Thus the divided[40] yield on market price plus a growth rate equals the return on equity expected by investors.[41]

This clearly requires that the yield term of the DCF equation be based upon *market price*. Yet when Mr. Loos calculated dividend yield in his Updated Direct Testimony,[42] he utilized *book value* to determine the high end of the range for dividend yield (5.75%). This unexplained deviation from the DCF model does not comply with Mr. Loos's own statement and should be rejected. The Commission should therefore consider only the low end of Mr. Loos's dividend yield range (2.50%), which closely approximates the dividend yield that Mr. Barnes found (2.88%).[43]

The most crucial aspect of the ROE analysis is the determination of the appropriate growth rate. The data that Mr. Loos used to choose his DCF growth rate are

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[40] So in original. This apparently should read "dividend."
[41] Loos Direct, Exh. 1, p. 31, lines 19-23.
[42] Loos Updated Direct, Exh. 2, Sch. LWL-4, fourth sheet.
[43] Barnes Direct, Exh. 11, Sch. 15, column (3).

shown in his Updated Direct Testimony, Exh. 2, Sch. LWL-4, fifth sheet. In the "recap" at the bottom of this sheet, Mr. Loos selected ranges for the growth in the cash flow per share, earnings per share, dividends per share, price per share and book value per share of his comparable companies. He testified that he chose these numbers "by inspection." Although one could quibble about how the numbers were chosen, they appear to fairly well represent the data elsewhere on the page.

But Mr. Loos's final determination of *g,* the DCF Growth Rate, at the bottom of the page is harder to understand. The average of the low end of the five ranges shown there is 4.50%; and the average of the high end of the five ranges shown there is 7.55%. But Mr. Loos chose a DCF Growth Rate range of 5.50% to 9.50%, without explanation. This is more than one percent higher than the average, and it is highly questionable.

Mr. Barnes chose a growth rate range of 5.18% to 6.18%. If Mr. Loos had used the simple average of his five growth rate ranges, he would have selected a range of 4.50% to 7.55%, which is broader than Mr. Barnes's range, but is very close to the same magnitude.

Mr. Loos relied only on his DCF analysis of the comparable companies. He made no attempt to check the reasonableness of his result by testing it against another model. Mr. Barnes followed the better practice by testing the reasonableness of his DCF results against results obtained by using the Capital Asset Pricing Model.[44]

Under cross-examination, Mr. Loos acknowledged that, other things being equal, the ROE that is required by a company with a high equity percentage is less than the ROE of a company with a lower equity percentage. To illustrate the point, consider the

[44] Barnes Direct, Exh. 11, Sch. 16.

following example. If other things are equal, the cumulative total risk to the investors in a company that has 100% equity is the same as the cumulative total risk to the investors in a company that has 50% equity and 50% debt. If the rate of return is, say, 8%, the required ROE for the first company would be 8%. The second company, on the other hand, might have an embedded cost of debt of 7% and an ROE or 9%; or an embedded cost of debt of 6% and an ROE of 10%. In any event, the required ROE for the second company would be higher than the required ROE for the first company.

But Mr. Loos has made no such adjustment to account for the high equity percentage that he recommends in this case. He proposes that Algonquin will require the same ROE as his comparable companies, even though he proposes a percentage of equity in Algonquin's capital structure that is much higher than the usual 50% or so, and much higher than the 47.88% that Mr. Barnes found from his selection of comparable companies.[45]

Mr. Loos did adjust his ROE upward, though, because of "Algonquin's extremely small size, lack of diversity in customer base, and nearly exclusive dependence on resort and time share property."[46] This adjustment is entirely subjective, and is unsupported. Algonquin is not "extremely small," but is part of a much larger company, and Mr. Loos has given the Commission no reason to find that the dependence on resort and time share property or the lack of diversity in the customer base increases Algonquin's risk. The Commission should reject this adjustment.

Finally, as noted above, the Commission has, in recent cases, placed emphasis on the number of, and the selection of the comparable companies. In this case, both Mr.

[45] Barnes Direct, Exh. 11, p. 11, lines 16-18.
[46] Loos Direct, Exh. 1, p. 33, lines 15-18.

Loos and Mr. Barnes ultimately relied on just four companies, and in fact three of Mr. Loos's comparable companies were also among Mr. Barnes's comparable companies.

After appropriate adjustments are made to Mr. Loos's recommendations, his testimony supports an ROE in the range of 7.00%[47] to 10.05%.[48] This is very close to Mr. Barnes's recommended ROE.

The testimony of Mr. Barnes on this issue is more credible than the testimony of Mr. Loos. The Commission should establish Algonquin's ROE within the range of 8.06% to 9.06%.

H. PAYROLL EXPENSE. What is the appropriate level of payroll expense that Algonquin should be allowed to recover in its rates?

Staff recommends increasing the staffing level in Algonquin's Missouri utility office to include 100% of the Utility Accountant's, and 50% of the Wastewater/Water Utility Superintendent's salary. Staff believes that using the payroll expense Silverleaf once incurred when it operated the utilities should be used as a standard for the most practical and economical way to staff the utilities yet still provide safe and adequate service. However, there are some differences between Silverleaf, who once operated the utilities, and Algonquin, which Staff believes warrants the inclusion in rates of more payroll expense than what Silverleaf allocated.

One difference Staff is concerned with is that quality-of-service issues, under Algonquin, are not matters which can be handled internally, as Silverleaf did. When Silverleaf ran the utilities, if there was a service issue, Silverleaf passed on the information to its utility affiliate, who then fixed the problem, and the matter stayed in-

[47] Consisting of a dividend yield of 2.50% and a growth rate of 4.50% (the low end of his adjusted range).
[48] Consisting of a dividend yield of 2.50% and a growth rate of 7.55% (the high end of his adjusted range).

house.[49] Staff believes it would now be beneficial for Algonquin to have an on-site representative who would be able to liaise between Algonquin (which would be the Wastewater/Water Utilities Superintendent), the utility operations, and resort management.[50] However, Staff does not recommend including 100% of the Superintendent's salary in rates. Only 50% of that employee's salary should be included in rates, as Staff believes that the employee would only need to dedicate 50% of his/her time to Missouri operations; the other 50% could very well be allocated to out-of-state utility operations owned by Algonquin.[51] Furthermore, the actual operator of the utility systems is contracted out to a firm called Construction Management Specialists, who reports directly to the Wastewater/Water Utilities Superintendent.[52] Acting as a liaison between the resorts, the utility operator, and Algonquin management should not require 100% of the Superintendent's time.

Another difference between Silverleaf and Algonquin, which Staff believes justifies the inclusion of 100% of the payroll costs of the Missouri Facility Accountant's salary, is management of customer accounts.[53] When Silverleaf owned the utilities, the Facility Accountant's task of managing customer accounts was less time-consuming because Silverleaf itself represented the largest account,[54] which justified only 50% of the Facility Accountant's salary being included in rates.[55] Now, since the utility and the resorts are no longer affiliated, the management of customer accounts has become more

[49] Vesely Direct, Exh. 8, p. 8, lines 6-8.
[50] Vesely Direct, Exh. 8, p. 8, lines 8-17.
[51] Vesely Direct, Exh. 8, p. 8, lines 8-17.
[52] T-436, lines 15-20; and T-443, lines 12-19.
[53] Vesely Direct, Exh. 8, p. 7, lines 17-23.
[54] Vesely Direct, Exh. 8, p. 7, lines 20-23.
[55] Vesely Direct, Exh. 8, p. 6, lines 14-17; and T-438 – T-439, line 1-2.

time-consuming, which Staff believes justifies the inclusion of all 100% of the Facility Accountant's salary in rates.[56]

Algonquin is seeking to have 100% of the Wastewater/Water Utility Superintendent's salary, 100% of the Missouri Facility Accountant's salary, and 100% of the Missouri Utilities Assistant's salary. Staff agrees with Algonquin on the allocation of the payroll costs for the Missouri Facility Accountant, for the reasons set out above, but disagrees as to the payroll costs for the Wastewater/Water Utility Superintendent, and the Missouri Utilities Assistant. Staff believes that only 50% of the Wastewater/Water Utilities Superintendent's salary should be included in rates, as discussed above.

Regarding the salary of the Missouri Utilities Assistant, Staff firmly believes that including any payroll expense for the Missouri Utilities Assistant would impose unnecessary expenses on the ratepayers, and should not be allowed.[57] The position of Missouri Utilities Assistant was created by Algonquin after acquiring the utilities; no comparable position existed when Silverleaf owned the utilities.[58] Because neither the scope nor extent of the utilities' operations has expanded since Algonquin purchased the systems, Staff recommends disallowing the payroll expenses of the Missouri Utilities Assistant.[59]

The Appropriate Level of Payroll Expense. The Staff recommends that the Company should be allowed to recover payroll expense in the amount of $177,128 from its ratepayers.

[56] Vesely Direct, Exh. 8, p. 7, lines 20-23; and p. 8, lines 1-3.
[57] Vesely Rebuttal, p. 4, ln. 18-21.
[58] Vesely Rebuttal, p. 4, ln. 6-23 and p. 5, ln. 1; Tr. Vol. 5, p. 435, ln. 25 and p. 436, ln. 1-3.
[59] Vesely Rebuttal, Exh. 9, p. 4, lines 6-23.

I. RATE CASE EXPENSE. Should the Commission allow Algonquin to recover in its rates any allowance for the rate case expenses that it incurred in presenting this case to the Commission? If so, how much rate case expense did Algonquin prudently incur, and over how many years should the rate case expense be amortized?

The Commission should not allow Algonquin to recover rate case expense, for two reasons: first, the Company should have utilized the small company rate case procedure; and second, the Company filed its case prematurely.

In addition, the Company failed to present evidence of the amount of rate case expense it actually incurred; granting the company's request would place a tremendously disproportionate burden on the ratepayers; and the Company incurred a substantial portion of its rate case expense in presenting its request to include "unrecorded plant" in rate base, which has no merit and should be rejected.

The Small Company Rate Case Procedure. The Commission established the small company rate increase case procedure to allow qualifying small companies, such as Algonquin, to seek a rate increase, without incurring the expense of hiring consultants and attorneys. Under this procedure, a small company can literally obtain a rate increase without any out-of-pocket expense, except for the price of a first-class postage stamp. The process was set up to minimize the cost to the company and, ultimately, the cost to the ratepayers.

But Algonquin shunned the small company rate case process because it perceived the results obtained by its predecessor, Silverleaf, to be unsatisfactory. Algonquin's perception centers on two complaints; first, that the small company rate case process takes too long; and second, that the resulting rate increases are not sufficient.

The Time Required to Process Silverleaf's Cases. Algonquin witness Loos complained especially about a rate case that Silverleaf filed on April 4, 1997, which did not conclude until 17 months later, on September 4, 1998, when new rates took effect.[60] The small company rate case process cannot be blamed for this delay, however, but was instead the fault of Silverleaf, as Staff witness Vesely explained.[61] This was because Silverleaf did not hold a certificate from the Commission on April 4, 1997, when it filed its rate case. Silverleaf did not obtain its certificate until November 26, 1997, when the Commission approved a merger case that Silverleaf and its predecessor, Ascension Resorts, jointly filed. The Commission then approved Silverleaf's request for a rate increase about 10 months later, on September 4, 1998. This case was processed within a reasonable time, especially in view of the plant-in-service issues that needed to be addressed.[62]

Mr. Loos also complained about another case that Silverleaf filed on August 3, 2000. This case remained open for at least 20 months, until April 26, 2002, when Staff opened an earnings investigation, because it believed that Silverleaf was overearning. Although the case was perhaps not closed as promptly as it should have been, Silverleaf was not harmed, because Staff did not find that Silverleaf was underearning. The "delay" in processing this case was not unreasonable.

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[60] Loos Rebuttal, Exh. 3, p. 4, lines 12-18.
[61] Vesely Rebuttal, Exh. 9, p. 4, line 14 – p. 5, line 10.
[62] Vesely Surrebuttal, Exh. 10, p. 5, lines 6-10.

<u>*Time Required to Process Other Small Company Cases.*</u> The results in other, more recent, cases are also instructive. Staff witness Dale W. Johansen prepared a table summarizing the key data for each of the small company rate increase requests that have been submitted to the Commission since the beginning of Fiscal Year 2004. This table was admitted into evidence as Exhibit 35. Thirty-seven requests have been received since July 1, 2003. Seven requests received within the last six months are pending. Nine requests were either rejected, closed, suspended, or withdrawn. The remaining 21 requests were processed to completion. The following table shows the time required to fully complete those 21 requests. In many instances, the time to fully complete these requests includes time related to agreed-upon extension of the "informal" part of the small company process and/or time related to case activities that occurred after the completion of the "informal" part of the process.

Company	Submitted	Effective	Months to complete
Timber Creek (sewer)	*7-15-03*	*7-31-04*	*12.52*
Hickory Hills (water)	3-30-04	12-20-04	8.67
Hickory Hills (sewer)	3-30-04	12-20-04	8.67
L.W. Sewer (sewer)	*5-03-04*	*5-31-05*	*12.90*
Suburban (water)	12-09-04	6-30-05	6.70
Noel (water)	3-14-05	6-30-05	3.53
Stockton Hills (water)	4-18-05	9-30-05	5.40
Middlefork (water)	4-28-05	12-17-05	7.63
KMB Utility (sewer)	5-2-05	2-21-06	9.68
KMB Utility (water)	*5-2-05*	*4-21-06*	*11.63*
Evergreen Lake (water)	5-2-05	10-27-05	5.71
Aqua Missouri Dev. (sewer)	*5-17-05*	*8-28-06*	*15.35*
Aqua Missouri RU (water)	*5-17-05*	*10-11-06*	*16.81*
Aqua Missouri CU (sewer)	*5-17-05*	*9-30-06*	*16.43*
Aqua Missouri CU (water)	*5-17-05*	*9-30-06*	*16.43*
Empire District Electric (water)	6-24-05	2-4-06	7.35
Hickory Hills (sewer)	*7-28-05*	*7-1-06*	*11.13*
Hickory Hills (water)	*7-28-05*	*7-1-06*	*11.13*

Taneycomo Highlands (sewer)	11-7-05	7-7-06	8.00
Franklin County Water (water)	12-12-05	10-15-06	10.10
Moore Bend (water)	5-25-06	12-07-06	6.40

Total time to complete 21 requests	212.17 months
Average time to complete each request	10.10 months

Thus, on average, all of these 21 small company rate increase requests were fully completed in less than the 11 months that is typically required for a full formal rate case. Although nine of these requests required more than 11 months to complete (those italicized above), the Staff notes that a review of the tracking files and case files for those requests shows that the time to complete all of those requests includes time related to activities that occurred after the "informal" part of the small company process was completed, and that the time to complete all but three of those requests includes time related to multiple agreed-upon extensions of the "informal" part of the process. Based on the above, the Staff does not believe the time required to process and complete small company rate increase requests justifies the huge expenditure that Algonquin has allegedly incurred in presenting this full formal rate case.

Rate Increases Granted. Algonquin witness Loos also suggested that the rate increases that Silverleaf obtained were not satisfactory. He noted that the rate increase in the 1997 case was only about 20% of what Silverleaf requested. And he said that in a subsequent rate case, the Staff found that relief was appropriate, but no relief was granted. He added that he "can't believe that Silverleaf believes that the small company process met its needs." But this is mere supposition. There is no direct evidence that Silverleaf was dissatisfied with the process and, as Mr. Loos himself noted, Silverleaf *agreed* with the Staff on the increase in the 1997 case. And although Silverleaf would have had the right to file a formal rate case if it was dissatisfied with the small company rate case process, it never did so.

The outcomes of the 21 small company rate increase requests cases that have been processed to completion since the beginning of Fiscal Year 2004 are again instructive, with regard to the companies' ability to obtain the rate increases they sought. The following table summarizes the results of those 21 requests:

Company	Requested	Granted	Percent Granted
Timber Creek (sewer)	$ 80,000	$ 80,000	100
Noel (water)	$ 42,000	$ 42,000	100
Middlefork (water)	$ 30,000	$ 30,000	100
Hickory Hills (sewer)	$ 2,500	$ 2,415	97
Hickory Hills (water)	$ 9,000	$ 8,180	91
Stockton Hills (water)	$ 5,725	$ 5,415	95
Empire District Electric (water)	$522,835	$469,140	90
Hickory Hills (sewer)	$ 5,000	$ 4,080	82
Moore Bend Water Company	$ 9,000	$ 6,673	74
Aqua Missouri CU (water)	$ 65,209	$ 45,341	70
Suburban (water)	$ 7,100	$ 4,190	59
Taneycomo Highlands	$ 9,250	$ 5,006	54
Evergreen Lake (water)	$ 9,550	$ 4,540	48
Aqua Missouri RU (water)	$330,464	$109,122	33
Aqua Missouri CU (sewer)	$568,675	$148,215	26
Franklin County Water (water)	$ 24,000	$ 4,342	18
L.W. Sewer (sewer)	$ 28,525	$ 4,740	17
KMB Utility (water)	$152,229	$ 9,220	6
KMB Utility (sewer)	$17,121	$ 775	5
Aqua Missouri Dev. (sewer)	$2,268	($ 4,732)	neg.
Hickory Hills (water)	$2,000	($ 840)	neg.

For seven of these requests (one-third of all the requests), the company obtained a rate increase that was at least 90% of the amount originally requested. The companies in this group ranged in size from very small to quite large. For another three of these requests, the companies obtained increases that were at least 70% of the amount originally requested. In another three of the requests, the companies obtained increases that were at least 48% of the amount originally requested. In the other eight cases, the company received no more than 33% of the amount it originally requested. The Staff believes that this range of recoveries is not much different than the range of recoveries that results from full formal rate cases. Based on this information, the Staff does not believe the size of the rate increases obtained through the small company rate increase process justifies the huge expenditure that Algonquin has allegedly incurred in presenting this full formal rate case.

Small Company Satisfaction with the Small Company Rate Case Process. Except for the conclusory and unsubstantiated statements and speculation by Mr. Loos, there was no evidence that small companies generally find the small company rate increase process unsatisfactory. In fact, small companies participated to a significant extent in the Commission's Small Company Rate Case Working Group a couple of years ago, to make the process work even better.

The Effect on Small Companies. Questions were raised at the hearing as to whether the small company rate increase process has led to the problems experienced by some of the troubled small companies that the Commission regulates. There was, however, no evidence to support such a conclusion.

One of the companies mentioned, Hickory Hills, has utilized the small company rate case process twice in recent years. (See the results of these cases in the tables above.) Hickory Hills did eventually go into receivership. This was not because of the small company rate case process, though, but because of the expense the company incurred and the results it obtained when its request went formal, with a hearing that required the company to hire an attorney.

Osage Water Company is also in receivership. It had attempted to use the small company rate case process a couple of times in recent years. (These cases are not shown in the foregoing tables.) There is no reason to suspect, however, that the small company rate case process contributed to Osage's problems.

Another company that is in receivership, Missouri Utilities, has not filed any rate case – formal or informal – in the last 15 years or so. Its problems cannot be attributed to the small company rate case process, either.

Likewise, neither Stoddard County Sewer Company nor Warren County Water and Sewer Company has filed a small company rate increase case in recent years. Stoddard County's problems resulted from the death of its owner, not from the small company rate case process. And Warren County's problems resulted from the poor management skills of its owner, and from his inattention to the company's utility systems and its customers, not from the small company rate case process.

There is no evidence to suggest that the problems of Central Jefferson County Utilities resulted from the futility or delays inherent in the small company rate case process.

Aqua Missouri recently filed four small company rate increase requests, which have been resolved. (See the results of these cases in the tables above.) This company will now file a new formal rate case to seek further rate relief.

Algonquin's Options. Algonquin could have pursued a similar course. It could have filed a small company rate case to resolve some of the issues in the case. Even if it could not have reached agreement with Staff to resolve all issues, it could have proceeded to hearing on the unresolved issues, as was done in the Hickory Hills and Aqua Missouri cases. By doing so, it could have obtained more immediate rate relief and could have significantly reduced its rate case expense.

But Algonquin made no attempt whatsoever to pursue the small company rate case process. Of course, that is their right. They are not obliged, by statute or rule or otherwise, to file a small company rate case. They can choose to spend their money any way that they wish. But Algonquin is not merely spending its own money. It is also asking the Commission to allow it to recover this expense from the ratepayers.

The Commission should only allow Algonquin to recover its rate case expense if the expenditures are prudent. The Staff submits that, in this case, Algonquin's decision to spend $225,000 (or more) on a formal rate case, even though it serves only about 900 customers, is not prudent.

Premature Filing. The second reason that Algonquin should not be allowed to recover this rate case expense is that the case was prematurely filed.

Algonquin acquired the assets of Silverleaf on August 15, 2005, and then filed this rate case based on a test year ending September 30, 2005. Of necessity, this required the Company to utilize 10-1/2 months of Silverleaf's operating data and only 1-1/2 months of Algonquin's operating data. The use of a combination of such data would be misleading, at best. The Commission therefore ordered Algonquin to update this test year data by one full year, to September 30, 2006.

Company witness Loos testified that Silverleaf's records were poor. He admitted that he had to gather 10-1/2 months of data from Silverleaf, gather 1-1/2 months of data from Algonquin, and merge the data just so he could file a pro forma test year, and that this process was time-consuming and expensive.[63] At greater expense to Algonquin, he then had to spend more time collecting and assembling data, in order to update the test year data so that it would include 12 months of Algonquin's operations, which is "[u]nder ideal circumstances," a good thing.[64]

This resulted in tremendous duplication of effort. Mr. Loos acknowledged that it cost perhaps $40,000 to assemble this data the first time (for the 12 months ending in September 2005) and a similar amount for the second time (for the update through September 2006).[65]

The premature filing served only to drive up the costs for both the Company and the Staff, and to make the case more difficult to analyze, with no discernible benefit to anyone. The Commission should not reward this imprudent premature filing and should not require the ratepayers to bear this imprudent expense.

Company's Failure to Prove Its Rate Case Expense. But even if the Commission finds that Algonquin's decision to file a formal rate case was prudent, there are other problems with the Company's request in this case. Foremost among these is that the Company has totally failed to prove up its rate case expense.

Algonquin's prefiled testimony contains no evidence whatsoever of the amount of rate case expense that Algonquin actually incurred. The only evidence of any sort is Mr. Loos's *projection* that the Company would spend $225,000 to present its case. During cross-examination, Mr. Loos did testify that the rate case expense would exceed that sum;

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[63] T-470, line 6 – T-471, line 21.
[64] T-471, line 22 – T-472, line 24.
[65] T-473, line 10 – T-474, line 16.

but he did not say how much the expense would come to, he provided no documentation or detail, and his bald statement was completely unsupported.

Over Staff's objections, the Commission admitted Exhibits 32 and 33, which were Algonquin's responses to data requests that it received from the Staff. Although these documents were admitted into evidence, the Commission should give them little weight, for several reasons. First, the statements in the DR responses were not verified. Second, the statements were hearsay, and the person who made them did not testify about the information contained therein. Third, the exhibits were offered and admitted during *re-direct* examination of a Company witness, so Staff and OPC were denied the opportunity to cross-examine the witness about the information contained therein. And fourth, the Staff's efforts to obtain information from the Company about rate case expense were frustrated by the Company's refusal to answer the Staff's data requests about seeking information about the Company's consulting agreement. The Company should not be allowed to hide the ball during discovery and trial preparation, and then belatedly present this document at a time when the Staff cannot even question the Company's witness.

Finally, there is no reason why the Staff should have been required to present the information contained in the DR response to the Commission at the hearing. The Staff simply has no duty to respond to evidence that the Company has not even offered. The burden of going forward on this issue is upon the Company, and the Commission should not reward – or even tolerate – the Company's failure to do so.

<u>*Rate Case Expense Is Enormous.*</u> Algonquin's request for rate case expense is almost unimaginably excessive. It amounts to an average of $3.79 per month for every one of Algonquin's water customers for the next five years, *plus* an average of $3.79 for

every one of Algonquin's sewer customers for the next five years. Mr. Loos acknowledged that it would amount to more than two dollars *per week* for each of the time share units at Timber Creek. The magnitude of this request is breathtaking! By comparison, the rate case expense allowed in the recent KCPL rate case will cost each ratepayer about 11 cents per month, and rate case expense allowed in the recent Aquiila case will cost each ratepayer about seven cents per month, on monthly bills that are much larger than Algonquin's bills for water and sewer service.

Algonquin could have reduced its rate case expense in a couple of ways: by resolving at least some of the issues through the small company rate case process; by not filing the rate case prematurely; and by not pursuing the novel and unprecedented claim that "unrecorded plant" should be included in rate base. The Company incurred about 30% of its rate case expense to present its "unrecorded plant" theory. This latter claim has no merit, and any rate case expense associated with that issued should be rejected outright.

The Commission should not allow Algonquin to recover any rate case expense from its customers, because this expense was not prudently incurred. In the alternative, the Commission should limit the rate case expense to $5,000.

J. RATE DESIGN. Should the Commission's order establish separate rates for each of Algonquin's three service territories, or should the Commission's order establish a unified rate for water service to Algonquin's service to the Ozark Mountain and Holiday Hill service territories?

Staff maintains the position that separate rates should be established for each of Algonquin's service territories. Staff believes that Algonquin's rates should be designed on the costs that are separately attributable to each of Algonquin's service areas, and that the specific rates for each service area should be based on the Class Cost of Service Study (CCOS) performed by James Russo, Rate and Tariff Examination Supervisor at the Missouri Public Service Commission.[66] These "district-specific rates" provide the only mechanism through which customers of Algonquin can be fairly and equitably treated. If single tariff pricing for Ozark Mountain and Holiday Hills were adopted, then a large cost in one district would raise rates for both districts,[67] and could result in one district subsidizing another.[68]

Staff's proposal to go to district specific pricing is based on differences between the systems and the customer bases at Ozark Mountain and Holiday Hills.[69] As Mr. Loos testified, there are several key differences between Holiday Hills and Ozark Mountain Resorts. The two resorts are located roughly twenty miles apart, and the systems are not physically connected in any way.[70] Holiday Hills is larger than Ozark Mountain in terms of area and number of units, and will eventually be substantially larger.[71] Holiday Hills also has a higher level of fire protection service than Ozark Mountain.[72] Furthermore, taken as a whole, the overall investment per customer is different between Holiday Hills and Ozark Mountain.[73]

It is clear from the testimony in this case, pre-filed and live, that Holiday Hills and Ozark Mountain are substantially different systems. Holiday Hills is larger and includes more existing infrastructure than Ozark Mountain. Further, as Mr. Loos

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[66] Russo Direct, Exh. 23, p. 1, lines 16-17; p. 5, lines 19-21.
[67] T-181, lines 8-13.
[68] T-193, lines 15-24.
[69] T-194, lines 15-19.
[70] T-177, lines 10-15.
[71] T-178, lines 1-3.
[72] T-178, lines 4-6.
[73] T-178, lines 10-12.

testified, Holiday Hills will eventually be significantly larger than Ozark Mountain,[74] which will continue the need for new construction of infrastructure at Holiday Hills. It would be unfair for customers of Ozark Mountain to be forced to finance the operations and mechanizations of Holiday Hills, without receiving any benefits from Holiday Hills. As a result of the considerable differences between the resorts, district-specific pricing is the only fair and equitable route for any rate increase which might occur at these resort properties.

K. RATE MITIGATION. Should any increase in rates be phased in, or be otherwise mitigated? If so, how?

Staff has no position on the issue of Rate Mitigation, and therefore offers no opposition to this issue.

CONCLUSION

Algonquin's rate increase request is nothing less than a thinly veiled attempt to recover the acquisition premium that resulted when it paid Silverleaf $3.8 million for utility assets with a rate base value of $1.4 million. The Company's unprecedented claim that "unrecorded plant" should be included in the Company's rate base is not supported by the evidence, and should be rejected.

The Staff's determination of the Company's pre-1993 rate base is supported by documentation of the original cost of the assets when first devoted to public service. The Company's determination is little more than guesswork, based on a series of assumptions, projections, and extrapolations, and is not supported by documentation, as the Commission has always required. The burden of proof in a rate case is upon the

[74] T-178, lines 1-3.

company seeking the rate increase, as required by Section 393.150, RSMo. The Company's estimate of rate base fails to satisfy this burden.

Algonquin's decision to shun the small company rate increase process and file a full formal rate case was imprudent, and the case was prematurely filed. The Commission should therefore deny the Company's request to recover its rate case expense from the ratepayers.

WHEREFORE, the Staff respectfully submits its Brief for the Commission's consideration in this case.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or emailed to all counsel of record this 20th day of February, 2007.

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