BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer	)	**File No. WR-2013-0461 *et al.***
Company's Application to Implement a General	)	YW-2014-0024
Rate Increase in Water and Sewer Service	)	YS-2014-0023

REPORT AND ORDER

Issue Date: April 30, 2014

Effective Date: May 30, 2014

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TABLE OF CONTENTS

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REGULATORY LAW JUDGE: Michael Bushmann, Senior Regulatory Law Judge

REPORT AND ORDER

I. Procedural History

A. Tariff Filings, Notice, and Intervention

On July 16, 2013, Lake Region Water & Sewer Company ("Lake Region") filed tariff sheets designed to implement a general rate increase for utility service, which resulted in the Missouri Public Service Commission ("Commission") opening a separate case for both water and sewer, File Nos. WR-2013-0461 and SR-2013-0459. The two cases were subsequently consolidated into File No. WR-2013-0461. The tariff sheets bear an effective date of August 15, 2013. In order to allow sufficient time to study the effect of the tariff sheets and to determine if the rates established by those sheets are just, reasonable, and in the public interest, the tariff sheets were suspended until June 13, 2014. The Commission directed notice of the filings and set an intervention deadline, but no persons requested to intervene in this matter.

B. Test Year and True-Up

The test year is a central component in the ratemaking process. Rates are usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.[1] From these four factors is calculated the "revenue requirement," which, in the context of rate setting, is the amount of revenue ratepayers must generate to pay the costs of producing the utility service they receive while yielding a reasonable rate of return to the

[1] *State ex rel. Union Electric Company v. Public Service Comm'n*, 765 S.W.2d 618, 622 (Mo. App. 1988).

investors.[2] A historical test year is used because the past expenses of a utility can be used as a basis for determining what rate is reasonable to be charged in the future.[3]

The parties agreed to, and the Commission adopted, a test year of twelve months ending on June 30, 2013. The Commission also established the true-up period, if one was required, to run through December 31, 2013, to reflect any significant and material impacts on Lake Region's revenue requirement. The use of a true-up audit and hearing in ratemaking is a compromise between the use of a historical test year and the use of a projected or future test year.[4] It involves adjustment of the historical test year figures for known and measurable subsequent or future changes.[5] However, the true-up is generally limited to only those accounts necessarily affected by some significant known and measurable change, such as a new labor contract, a new tax rate, or the completion of a new capital asset. The true-up is a device employed to reduce regulatory lag, which is "the lapse of time between a change in revenue requirement and the reflection of that change in rates."[6]

C. Local Public Hearing

On August 27, 2013, the parties filed a *Joint Proposed Procedural Schedule*, which included a recommendation for the date and location for a local public hearing to give Lake Region's customers an opportunity to respond to the requested rate increase. The hearing was held at City Hall, in the City of Osage Beach, on December 11, 2013. No persons testified at the hearing, and no exhibits were offered or admitted into the record.[7]

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[2] *State ex rel. Capital City Water Co. v. Public Service Comm'n*, 850 S.W.2d 903, 916 n. 1 (Mo. App. 1993).
[3] *See State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Comm'n*, 585 S.W.2d 41, 59 (Mo. banc 1979).
[4] *St. ex rel. Missouri Public Service Comm'n v. Fraas,* 627 S.W.2d 882, 887-888 (Mo. App. 1981).
[5] *Id.* at 888.
[6] *In the Matter of St. Louis County Water Company*, Case No. WR-96-263 (*Report & Order*, issued December 31, 1996), at p. 8.
[7] Transcript, Vol. IV.

D. Stipulations

On January 31, 2014, the parties jointly filed a *Joint Stipulation of Undisputed Facts*, which pertain primarily to the issue of availability fees. On February 5, 2014, the parties filed a *Joint Stipulation of Additional Material Undisputed Facts*, which included the parties' agreements for rate design and revenue requirements. The Commission, having fully examined these stipulations and received them into the record of the hearing, will address the specific fact stipulations in its findings of facts and conclusions of law.

On February 11, 2014, the parties filed a *Unanimous Partial Stipulation and Agreement*. In this stipulation and agreement the parties agreed to the revenue requirements reflected in the Staff accounting schedules (attached thereto as Appendices A, B, and C), which were subsequently amended on March 14, 2014. The stipulation and agreement also resolved all but four of the remaining issues in dispute between the parties. The Commission found the stipulation and agreement to be reasonable and approved it on February 19, 2014 to become effective on March 21, 2014.

On March 17, 2014, the parties filed a *Unanimous Partial Stipulation and Agreement as to True-Up Issues.* The stipulation and agreement resolved previously disputed true-up issues and was approved by the Commission on March 26, 2014 to become effective on April 5, 2014. The issues resolved in these two partial stipulations and agreements will not be addressed further in this report and order, except as they may relate to any unresolved issues.

E. Evidentiary Hearing

The evidentiary hearing was held on February 18, 2014.[8] During the hearing, the parties presented evidence relating to the following four unresolved issues previously identified by the parties:

1. Availability fees:

   Should availability fees collected from owners of undeveloped lots in Lake Region's service territory be classified as Lake Region revenue or applied against rate base?

2. Capital structure:

   a) Should the capital structure for Lake Region be based on its actual capital structure or a hypothetical capital structure?

   b) If the capital structure for Lake Region should be based on its actual capital structure, what is Lake Region's actual capital structure?

   c) If the capital structure for Lake Region should be based on a hypothetical capital structure, what is a balanced and reasonable capital structure for Lake Region?

3. Return on equity:

   What is the appropriate return on equity for Lake Region?

4. Legal fees:

   a) Should the legal fees incurred during the test year for Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer be included in the calculation of rates for Lake Region?

   b) If so, what is the appropriate mechanism for recovery of these costs?

[8] Transcript, Vol. VIII.

F. Case Submission

During the evidentiary hearing held on February 18, 2014 at the Commission's offices in Jefferson City, Missouri, the Commission admitted the testimony of 13 witnesses, received 28 exhibits into evidence, and took official notice of evidence from several prior Commission cases.[9] Post-hearing briefs were filed according to the post-hearing procedural schedule. The final post-hearing briefs were filed on April 4, 2014, and the case was deemed submitted for the Commission's decision on that date.[10]

II. General Matters

A. General Findings of Fact

1. Lake Region Water & Sewer Company ("Lake Region") is a Missouri corporation in good standing with its principal office and place of business located at 62 Bittersweet Road, Lake Ozark, Missouri 65049. Lake Region possesses a certificate of convenience and necessity, issued by the Commission on December 27, 1973 in Mo PSC Case No. 17,954, to provide water and sewer service in Missouri. Lake Region is a water corporation pursuant to Section 386.020(59), RSMo Supp. 2013, a sewer corporation pursuant to Section 386.020(49), RSMo Supp. 2013, and, consequently, a public utility within the meaning of 386.020(43), RSMo Supp. 2013, and thereby subject to the jurisdiction of the Commission pursuant to Section 386.250(3) and (4), RSMo 2000.[11]

[9] At the hearing, the regulatory law judge admitted the two joint stipulations of fact into the record and took official notice of the following: 1) all Commission orders issued in Lake Region's 2010 rate case, SR-2010-0110 and WR-2010-0111; 2) all admitted exhibits and hearing transcript pages referred to in the stipulations; 3) the following exhibits or other filings made in the 2010 rate case: Exhibits 43-48, Lake Region's reply to Staff's response to Request from Agenda on April 7, 2010, and Lake Region's response to May 19, 2010 Order of the Commission; 4) all filings made in the working dockets WW-2011-0043, SW-2011-0042, and WW-2009-0386; and 5) testimony from the CCN case, WA-95-164, including Martin Hummel and Gregory Meyer.

[10] "The record of a case shall stand submitted for consideration by the commission after the recording of all evidence or, if applicable, after the filing of briefs or the presentation of oral argument." Commission Rule 4 CSR 240-2.150(1).

[11] *Joint Stipulation of Additional Material Undisputed Facts*, No. 1.

2. The Office of the Public Counsel ("Public Counsel") is a party to this case pursuant to Section 386.710(2), RSMo 2000, and by Commission Rule 4 CSR 240-2.010(10).[12]

3. The Staff of the Missouri Public Service Commission ("Staff") is a party to this case pursuant to Section 386.071, RSMo 2000, and Commission Rule 4 CSR 240-2.010(10).[13]

4. Lake Region provides water service to approximately 658 customers and sewer service to approximately 635 customers in its Shawnee Bend service area; and sewer service to approximately 245 customers in its Horseshoe Bend service area.[14]

5. Lake Region's water system comprises: (1) two deep wells, each with a pumping capacity of 360,000 gallons per day; (2) a 200,000 gallon elevated water storage tank; and, (3) a total of approximately 96,847 feet of water mains.[15]

6. Lake Region's sewer system comprises: (1) seven sewage treatment plants: (a) Lodge, with a 326,500 gallon daily capacity, (b) Racquet Club, with a 292,500 gallon daily capacity, (c) Charleston Condominiums, with a 24,000 gallon daily capacity, (d) Shawnee Bend, with a 100,000 gallon daily capacity, (e) Grandview, with a 50,000 gallon daily capacity, (f) Maywood, with a 12,800 gallon daily capacity, and (g) Blackhawk, with a 1,387 gallon daily capacity; (2) multiple lift stations; and, (3) a total of approximately 8,924 feet of collecting sewers.[16]

[12] *Joint Stipulation of Additional Material Undisputed Facts*, No. 3.
[13] *Joint Stipulation of Additional Material Undisputed Facts*, No. 2.
[14] *Joint Stipulation of Additional Material Undisputed Facts*, No. 4.
[15] *Joint Stipulation of Additional Material Undisputed Facts*, No. 5.
[16] *Joint Stipulation of Additional Material Undisputed Facts*, No. 6.

7. The majority of Lake Region's customers are single family residential, but approximately 41% of Lake Region's revenues are derived from commercial and multi-family sewer customers located in the Horseshoe Bend service area.[17]

8. Lake Region's existing water and sewer rates are based on a report and order issued by the Commission in File Nos. SR-2010-0110 and WR-2010-0111, which became effective on September 6, 2010 (the "2010 rate case"). In that report and order, the Commission ordered Lake Region to file a new general rate increase request no later than three years following the effective date of the report and order.[18]

9. The proposed tariffs filed by Lake Region in this case are designed to generate an aggregate revenue increase of approximately $218,762, or 23%, which would affect all Lake Region customers.[19]

10. In order to determine the appropriate level of utility rates, the Commission must calculate a revenue requirement for Lake Region, which is the increase or decrease in revenue Lake Region needs in order to provide safe and reliable service, as measured using Lake Region's existing rates and cost of service.[20]

11. The revenue requirement calculation can be identified by a formula as follows:[21] Revenue Requirement = Cost of Providing Utility Service or RR= O + (V - D) R where,

[17] Lake Region Ex. 1, Summers Direct, p. 3.
[18] *Id.*
[19] *Id.* at p. 4.
[20] Staff Ex. 3, Bolin Direct, p. 4.
[21] *Id*.

RR	=	Revenue Requirement;
O	=	Operating Costs; (such as fuel, payroll, maintenance, etc., Depreciation and Taxes);
V	=	Gross Valuation of Property Used for Providing Service;
D	=	Accumulated Depreciation Representing the Capital Recovery of Gross Property Investment.
(V – D)	=	Rate Base (Gross Property Investment less Accumulated Depreciation = Net Property Investment)
R	=	Overall Rate of Return or Weighted Cost of Capital
(V - D) R	=	Return Allowed on Net Property Investment

12. A test year is a historical year used as the starting point for determining the basis for adjustments that are necessary to reflect annual revenues and operating costs in calculating any shortfall or excess of earnings by the utility. Annualization and normalization adjustments are made to the test year results when the unadjusted results do not fairly represent the utility's most current annual level of existing revenue and operating costs.[22]

13. The test year for this case is the twelve months ending June 30, 2013.[23]

14. The Commission also selected a true-up period ending December 31, 2013, in order to account for any significant changes in Lake Region's cost of service that occurred after the end of the test year period but prior to the tariff operation of law date.[24]

15. A normalization adjustment is an adjustment made to reflect normal, on-going operations of the utility. Revenues or costs that were incurred in the test year that are determined to be atypical or abnormal will get specific rate treatment and generally require some type of adjustment to reflect normal or typical operations. The ratemaking process removes abnormal or unusual events from the cost of service calculations and replaces those events with normal levels of revenues or costs.[25]

[22] *Id.* at p. 5.
[23] *Id.*
[24] *Id.* at p. 6.
[25] *Id.* at p. 8.

16. An annualization adjustment is made when costs or revenues change during the audit period that will be ongoing at a level different than they existed during the audit period.[26]

17. A cost of capital analysis must be performed to determine a fair rate of return on investment (rate base) used in the provision of utility service. Rate base represents the utility's net investment used in providing utility service.[27]

18. The net income required for Lake Region is calculated by multiplying the rate of return by the rate base established as of June 30, 2013. The result represents net income required. Net income required is then compared to net income available from existing rates to determine the incremental change in Lake Region's rate revenues required to cover its operating costs and provide a fair return on investment used in providing utility service.[28]

19. The Commission finds that any given witness's qualifications and overall credibility are not dispositive as to each and every portion of that witness's testimony. The Commission gives each item or portion of a witness's testimony individual weight based upon the detail, depth, knowledge, expertise and credibility demonstrated with regard to that specific testimony. Consequently, the Commission will make additional specific weight and credibility decisions throughout this order as to specific items of testimony as is necessary.[29]

20. Any finding of fact reflecting the Commission has made a determination between conflicting evidence is indicative that the Commission attributed greater weight to

[26] *Id.*
[27] *Id.* at p. 6.
[28] *Id.*
[29] Witness credibility is solely a matter for the fact-finder, "which is free to believe none, part, or all of the testimony". *State ex rel. Public Counsel v. Missouri Public Service Comm'n*, 289 S.W.3d 240, 247 (Mo. App. 2009).

that evidence and found the source of that evidence more credible and more persuasive than that of the conflicting evidence.[30]

B. General Conclusions of Law

Lake Region is a sewer corporation, a water corporation and a public utility as defined in Sections 386.020(49), 386.020(59), and 386.020(43), RSMo Supp. 2013, respectively, and as such is subject to the personal jurisdiction, supervision, control and regulation of the Commission under Chapters 386 and 393 of the Missouri Revised Statutes. The Commission's subject matter jurisdiction over Lake Region's rate increase request is established under Section 393.150, RSMo 2000.

Sections 393.130 and 393.140, RSMo 2000, mandate that the Commission ensure that all utilities are providing safe and adequate service and that all rates set by the Commission are just and reasonable. Section 393.150.2 makes clear that at any hearing involving a requested rate increase the burden of proof to show the proposed increase is just and reasonable rests on the corporation seeking the rate increase. As the party requesting the rate increase, Lake Region bears the burden of proving that its proposed rate increase is just and reasonable. In order to carry its burden of proof, Lake Region must meet the preponderance of the evidence standard.[31] In order to meet this standard, Lake Region must convince the Commission it is "more likely than not" that Lake Region's proposed rate increase is just and reasonable.[32]

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

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

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

In determining whether the rates proposed by Lake Region are just and reasonable, the Commission must balance the interests of the investor and the consumer.[33] In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[34]

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

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[35]

The Supreme Court has further indicated:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be

[33] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, (1944).
[34] *Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 690 (1923).
[35] *Bluefield,* at 692-93.

> commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[36]

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

> Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.[37]

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

> [T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' … Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts.[38]

III. Disputed Issues

A. Availability Fees

Findings of Fact

Lake Region's Ownership and Certificate History

21. On August 10, 1971, Four Seasons Lakesites Water & Sewer Company ("Lakesites W&S") was incorporated to provide water and sewer service for the Four Seasons Lakesites, Inc. development.[39]

[36] *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944) (citations omitted).
[37] *Federal Power Commission v. Natural Gas Pipeline Co*. 315 U.S. 575, 586 (1942).
[38] *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).
[39] *Joint Stipulation of Undisputed Facts,* No. 1.

22. On February 27, 1973, Four Seasons Lakesites Water & Sewer Company was issued a Permit of Approval from the Division of Health to supply water to the public.[40]

23. The Commission granted Lakesites W&S its certificate of convenience and necessity ("CCN") to provide water service effective December 27, 1973 in Case No. 17,954. The Commission amended the company's certificate in Case No. 18,002 effective May 16, 1974, to expand its water service to areas immediately adjacent to the previously authorized certificated area.[41]

24. Ultimately, Lakesites W&S, or its successors-in-interest, received Commission approval for providing sewer service and to expand its certificated water and sewer service areas as follows:

a. December 16, 1975: Effective date of Commission Order granting an expansion to Lakesites W&S's CCN. Case No. 18,416.

b. March 14, 1980: Additional authority granted to Lakesites W&S in an unreported order. Case No. WA-79-266.

c. February 16, 1990: Additional authority granted to Lakesites W&S to provide sewer service in an unreported order. Case No. SA-89-135.

d. July 11, 1997: Effective date for Commission order approving a Unanimous Stipulation to grant Lakesites W&S Company a CCN to extend its sewer operation to areas in Shawnee Bend and Horseshoe Bend and adjust water tariffs (depreciation schedules). The Company already had a CCN to provide sewer service in part of Horseshoe Bend. Case No. WA-95-164.

[40] *Joint Stipulation of Undisputed Facts,* No. 2.
[41] *Joint Stipulation of Undisputed Facts,* No. 3.

e. October 9, 1998: Effective date for Commission order extending Four Seasons Water & Sewer Company's ("Four Seasons W&S") CCN for its sewer operations. Case No. SA-98-248.

f. September 1, 2000: Effective date for Commission order granting Lake Region an extension of its CCN to provide water and sewer service in the Shawnee Bend area. Case No. SA-2000-295.

g. November 5, 2006: Effective date of Commission order approving expansion of Lake Region's CCN. WA-2005-0463 and WA-2005-0464. [42]

25. In the WA-95-164 CCN case, the Commission did not include availability fees in the ratemaking process for the Shawnee Bend area or in tariffs for Lakesites W&S to render service in that area.[43] A Staff witness in that case testified that "the Developer and the Company need to enter into a written agreement whereby the Developer assigns the right to the Company to bill and receive availability fees".[44]

26. In March of 2004, the Commission denied Lake Region's requests for CCNs in Case Number SA-2004-0182.[45]

27. In addition to the many certificate cases, Lakesites W&S, or its successors-in-interest, appeared before the Commission seeking rate increases in the following cases:

a. April 16, 1975: Effective date for Commission order denying Lakesites W&S's tariff for an imposition of rates for unmetered service. Case No. 18,081.

[42] *Joint Stipulation of Undisputed Facts,* No. 4.
[43] Transcript, Vol. VIII, p. 201, 218.
[44] In the Matter of the Application of Four Seasons Lakesites Water & Sewer Company for a Certificate of Convenience and Necessity Authorizing it to Construct, Install, Own, Operate, Control, Manage and Maintain Water and Sewer Utility Properties for the Public Located in an Unincorporated Area in Camden County and Miller County, Missouri, Generally Comprising the Eastern Half of the Area Known as "Shawnee Bend", Case No. WA-95-164, Rebuttal Testimony of Gregory R. Meyer, p. 6.
[45] *Joint Stipulation of Undisputed Facts,* No. 5.

b. December 5, 1991: Effective date for Commission order granting Lakesites W&S a rate increase request pursuant to a unanimous agreement. Case No. WR-92-59.

c. August 2, 1998: Effective date for Commission order granting Four Seasons W&S an increase in rates for its sewer service after the filing of a unanimous disposition agreement. This increase in rates involved the completed expansion at the Racquet Club wastewater treatment plant; Case No. SR-98-564.[46]

28. With regard to ownership of the company:

a. December 29, 1992: The Commission approved Lakesites W&S application to sell its water system on Horseshoe Bend to the Ozark Shores Water Company ("Ozark Shores"), but Lakesites W&S continued to provide sewer service to the Horseshoe Bend area. Unreported Case No. WM-93-24.

b. October 9, 1998: Lakesites W&S changed its name to Four Seasons Water and Sewer Company ("Four Seasons W&S") in Case No. SA-98-248.

c. May 16, 1999: The Commission recognized Four Seasons W&S's change of name to Lake Region Water & Sewer Company (Lake Region) in Case No. WO-99-469.[47]

29. On December 2, 1969, Harold Koplar, the original developer of Four Seasons Lakesites, Inc., executed the original Declaration of Restrictive Covenants for the development that would eventually encompass Lake Region's service area.[48]

30. On March 10, 1971, Harold Koplar, the original developer of Four Seasons Lakesites, Inc., executed the [First] Amended Declaration of Restrictive Covenants ("1st

[46] *Joint Stipulation of Undisputed Facts,* No. 6.
[47] *Joint Stipulation of Undisputed Facts,* No. 7.
[48] *Joint Stipulation of Undisputed Facts,* No. 8.

Covenants") for the development that would eventually encompass Lake Region's service area.[49]

31. Article VI of the 1st Covenants establishes Four Seasons Lakesites Property Owners Association (Lakesites POA), and all property owners in the development automatically become a member in the Association when they purchase property.[50]

32. Article VII of the 1st Covenants prohibits the use of outside toilets and requires that sanitary waste disposal conform with the recommendations of the developer or its successors, the state and county health boards.[51]

33. Articles VII and VIII of the 1st Covenants pertain to the central sewage disposal system and water works. These sections:

a. establish a "minimum monthly availability charge for water, water service and the accommodations afforded the owners of said lots by said water works systems" that would commence when water service was available and continue regardless whether the property owner takes water service from the central system to be constructed within the development;

b. allow for the construction of individual wells until such time as the central water system is constructed, after which the property owner must connect to the central system;

c. establish "a minimum monthly availability charge for sewage disposal and treatment and the accommodations afforded the owners of said lots by said sewage disposal system" that would commence upon the availability for use of a sewage collection main that leads to an operating sewage treatment facility and

[49] *Joint Stipulation of Undisputed Facts,* No. 9.
[50] *Joint Stipulation of Undisputed Facts,* No. 10.
[51] *Joint Stipulation of Undisputed Facts,* No. 11.

continue regardless whether the property owner connects to the central sewage to be constructed within the development;

d. allow for the construction of individual sewer systems, i.e. septic tanks and tile fields, until completion of the central sewer system, after which the property owner must connect to the central system;

e. provide that no charge will be made to the lot owners for the right to connect to the water and/or sewer systems; and,

f. provide that the owner or owners of the water works system and sewage disposal system will be a privately owned utility authorized by a CCN issued by the Commission and all availability charges, and times and methods of payment, shall be provided in schedules or rates and rules to be approved by the Commission.[52]

34. Article VIII of the 1st Covenants further provides that the availability fees are to be paid to the owner or owners of the sewage disposal system and water works system and that any "unpaid [availability] charges shall become a lien on the lot or lots to which they are applicable as the date the same became due."[53]

35. In addition to agreeing to the restrictive covenants upon the purchase of an undeveloped lot, the owner of each lot executed a separate water and sewer agreement, the provisions of which mirrored those in the 1st Covenants.[54]

36. On January 14, 1986, the Second Amended and Restated Declaration of Restrictive Covenants was executed by the developer of Four Seasons Lakesites, Inc.[55]

[52] *Joint Stipulation of Undisputed Facts,* No. 12.
[53] *Joint Stipulation of Undisputed Facts,* No. 13.
[54] *Joint Stipulation of Undisputed Facts,* No. 14.
[55] *Joint Stipulation of Undisputed Facts,* No. 15.

37. On July 2, 1996, Peter N. Brown, successive developer for Four Seasons Lakesites, Inc., executed the Third Amended and Restated Declaration of Restrictive Covenants (3rd Covenants).[56]

38. Article VII of the 3rd Covenants pertains to Lakesites POA. All property owners in the development automatically become a member in the Lakesites POA when they purchase property.[57]

39. Article VIII of the 3rd Covenants prohibits the use of outside toilets and requires that sanitary waste disposal conform with the recommendations of the developer or its successors, the state and county health boards and the Missouri Department of Natural Resources (DNR).[58]

40. Article IX(A) of the 3rd Covenants duplicates the provisions from prior declarations relating to the water system, but the water system only. This duplication includes the provisions concerning availability fees. This article includes the provision that owners of the water works system will be a privately owned utility authorized by a CCN issued by the Commission and all availability charges, and times and methods of payment thereof, shall be provided in schedules or rates and rules to be approved by the Commission, or if not so provided, as determined by the owner of the water works system.[59]

41. Article IX(C) of the 3rd Covenants provides for a plan for sewage treatment by individual treatment facilities, which must meet the specifications of Lakesites POA's DNR-approved plan or by "other methods of sewage treatment by the Development." It also provides that Lakesites POA will periodically maintain each individual treatment facility and each lot owner is required to pay a monthly maintenance fee to the POA for administering

[56] *Joint Stipulation of Undisputed Facts,* No. 16.
[57] *Joint Stipulation of Undisputed Facts,* No. 17.
[58] *Joint Stipulation of Undisputed Facts,* No. 18.
[59] *Joint Stipulation of Undisputed Facts,* No. 19.

the plan. The 3rd Covenants do not mention or require any availability fees for sewer service to be paid to the developer or to Four Seasons Lakesites Water & Sewer Company.[60]

42. The "Development," for purposes of Article IX(C) of the 3rd Covenants, refers to the Horseshoe Bend lots.[61]

43. Article IX(E) of the 3rd Covenants provides that, barring certain exceptions, "all homes and other structures requiring sewage or waste water disposal facilities, shall conform to the plan for sewage treatment; no such home or structure may be occupied unless so connected to the sewage treatment facility and no septic tank, cesspool or other means of disposal of sewage on an individual lot may be used in the subdivisions."[62]

44. There are multiple amendments to the 3rd Covenants.[63]

45. The amendment to the 3rd Covenants executed on July 23, 2009 contains specific provisions regarding the water and sewer systems.[64]

46. Article IX in July 23, 2009 amendment removes and replaces the entire Article IX from the 3rd Covenants, and provides, *inter alia*:

a. Shawnee Bend Lot Owners must "pay the owner of the central water system, or its assigns or designees, a monthly availability charge of Ten Dollars ($10.00), unless the Owner of the Lot is contractually obligated to Developer, or Developer's assign to pay a different amount;"

b. The water availability fee for Shawnee Bend Lot Owners commences upon the availability of water in a water system distribution main provided for the Lot and

[60] *Joint Stipulation of Undisputed Facts,* No. 20.
[61] *Joint Stipulation of Undisputed Facts,* No. 21.
[62] *Joint Stipulation of Undisputed Facts,* No. 22.
[63] *Joint Stipulation of Undisputed Facts,* No. 23.
[64] *Joint Stipulation of Undisputed Facts,* No. 24.

terminates when the Owner of the Lot connects his Lot to the water distribution main.

c. Unpaid water availability fees become a lien on the Lot the date they become due.

d. Shawnee Bend Lot Owners must "pay the owner of the central sewer system, or its assigns or designees, a monthly availability charge of Fifteen Dollars ($15.00), unless the Owner of the Lot is contractually obligated to Developer, or Developer's assign to pay a different amount."

e. Horseshoe Bend Lot Owners must pay the owner of the water works system a minimum monthly availability charge (amount not specified).

f. The Owner of the Horseshoe Bend water works system will be a privately owned public utility authorized by a certificate of public convenience and necessity issued by the Commission to operate the water works system.

g. The availability fees charged for the Horseshoe Bend Water System shall be provided in the Schedules of Rate and Rules. Regulations and conditions for water services shall be approved by the Commission (or any successor) and if not so provided will be determined by the owner of the water works.

h. Unpaid sewer fees for maintenance, owed to Lakesites POA, become a lien on the Lot and may be enforced by the Association.

i. The water and sewer amendment shall survive the execution and recording of the Fourth Amended and Restated Declaration and shall remain in full force and effect and be incorporated into the Fourth Amended and Restated Declaration.[65]

[65] *Joint Stipulation of Undisputed Facts,* No. 25.

47. All references to regulation by the Commission in the 3rd Covenants apply to the Horseshoe Bend Water System, which is not at issue in this case since this system was sold and became Ozark Shores Water Company in 1992.[66]

48. On October 1, 2009, the Fourth Amended and Restated Declaration of Restrictive Covenants ("4th Covenants") was executed by Peter Brown, Vice-President of Four Seasons Lakesites, Inc.[67]

49. Article 9 of the 4th Covenants states that all provisions relating to the water and sewer systems and treatment are set forth in the Amendment to the 3rd Covenants dated July 22, 2009 (executed July 23, 2009).[68]

50. Recital E in the 4th Covenants indicates the Declarant Developer may amend the Declaration at any time until all the lots in development have been sold.[69]

51. All of the lots developed by Four Seasons Lakesites, Inc. on Shawnee Bend have been sold.[70]

52. Section 19.3 of the 4th Covenants allows the property owners to seek amendment of the Declaration subject to certain conditions. Those conditions include:

a. The Declaration is binding until January 15, 2015, after which it is automatically renewed unless the owners of 90% of the lots vote to terminate the Declaration.

b. The Declaration may be amended at any time by the Developer at the request or with the consent of the Board until such time as all lots are sold, at which such time the Declaration may be amended by the affirmative vote of two-thirds of the owners of all of the lots entitled to vote.

[66] *Joint Stipulation of Undisputed Facts,* No. 26.
[67] *Joint Stipulation of Undisputed Facts,* No. 27.
[68] *Joint Stipulation of Undisputed Facts,* No. 28.
[69] *Joint Stipulation of Undisputed Facts,* No. 29.
[70] *Joint Stipulation of Undisputed Facts,* No. 30.

c. In the case of amendment by two-thirds of the property owners the amendment shall be executed by the requisite lot owners or the Lakesites POA.[71]

53. The 4th Covenants constitute an agreement between Peter N. Brown, successive developer for Four Seasons Lakesites, Inc., and the property owner. It also creates obligations between the property owner and Lakesites POA.[72]

54. Lake Region is not a party to any of the restrictive covenants that establish the availability fees.[73]

55. The 3rd and 4th Covenants do not represent that the Commission would determine or tariff rates for availability fees.[74]

56. With respect to the water systems, the 3rd and 4th Covenants provide that if the Commission does not provide or approve regulations and conditions for services, they will be determined by the owner of the system.[75]

57. The specimen land sales contract utilized by Four Seasons Lakesites, Inc. also contains provisions regarding the charging of availability fees. Paragraph 9 (B) and (C) provide:

a. all lots in the development will be served by a central water system;

b. the buyer agrees to pay availability fees until the central water system is completed to the point that a main water line runs in front of the buyer's property;

c. the availability fee for water is $10.00 per month;

d. the availability fee for water shall be paid to the seller or the seller's assignee, Lake Region Water & Sewer Co.;

[71] *Joint Stipulation of Undisputed Facts,* No. 31.
[72] *Joint Stipulation of Undisputed Facts,* No. 32.
[73] Transcript, Vol. VIII, p. 235.
[74] *Joint Stipulation of Undisputed Facts,* No. 33.
[75] *Joint Stipulation of Undisputed Facts,* No. 34.

e. the buyer agrees to pay all cost for connecting buyer's home to the central water system;

f. all lots in the development will be served by a central sewer system;

g. the buyer agrees to pay a monthly availability fee to the seller or seller's assignee until such time as the buyer constructs a home on the property; and,

h. once the buyer constructs a home, the buyer shall pay the sewer system operator a one-time connection fee and monthly fee for sewer service.[76]

Purpose of Availability Fees

58. In Commission Case Number 17,954, the original certification case, the Commission received into evidence an engineering report and the testimony of James W. French, registered professional engineer.[77]

59. The engineering report and testimony demonstrate that the economic feasibility of constructing the water and sewer system for what would ultimately become the service area for Lake Region was dependent upon the use of availability fees charged to the purchasers of the undeveloped lots.[78]

60. A copy of a separate availability fee agreement is attached to the engineering report. The availability fee agreement contains provisions mirroring the terms for water and sewer service outlined in the 1st Covenants.[79]

61. The Commission's Report and Order in Case No. 17,954, effective December 27, 1973, ("1973 Order") granting Four Seasons Lake Sites Water and Sewer Company (Lake Region's predecessor in interest) its CCN for water service, acknowledges

[76] *Joint Stipulation of Undisputed Facts,* No. 35.
[77] *Joint Stipulation of Undisputed Facts,* No. 36.
[78] *Joint Stipulation of Undisputed Facts,* No. 37.
[79] *Joint Stipulation of Undisputed Facts,* No. 38.

the use of availability fees and distinguishes the agreement for those charges from the rates and charges proposed for rendering metered and unmetered water service.[80]

62. The 1973 Order requires Lake Region's predecessor in interest to file tariffs including the rates for metered and unmetered water service. The Commission's order does not require the tariffing of availability fees.[81]

63. The collection of availability fees, by the terms and timing of the original agreements, began prior to construction or completion of the water and sewer systems and were collected to make construction of the systems feasible.[82]

64. The purpose for establishing the availability fees was to recover the investment in the water and sewer systems, not to maintain or repair the existing operations of the systems once they were constructed.[83]

65. The cost of that plant investment incurred by the developer has been treated as a contribution in aid of construction ("CIAC") and subtracted from the rate base upon which the company earns a return for ratemaking purposes. The amount of that plant investment donated by the developer associated with the availability fees is approximately $5.3 million.[84]

66. Lake Region witness Larry R. Summers testified credibly that by his calculations it would take more than 45 years to recoup the developer's investment of $5.3 million through the use of availability fees.[85]

67. People who purchase lots who are subject to paying the availability fees receive a benefit from paying the availability fees. That primary benefit is access to required

[80] *Joint Stipulation of Undisputed Facts,* No. 39.
[81] *Joint Stipulation of Undisputed Facts,* No. 40.
[82] *Joint Stipulation of Undisputed Facts,* No. 41.
[83] *Joint Stipulation of Undisputed Facts,* No. 42.
[84] Lake Region Ex. 2, Summers Rebuttal, p. 9.
[85] *Id.*

utility service, in this instance potable water and sewage treatment, without having to sustain additional costs of installing a well or a septic system. A secondary benefit for paying the fees is the avoidance of having a lien placed on the property by operation of the terms of the land sales contract or the restrictive covenants. Having the infrastructure in place also facilitates the sale of lots by complying with deed restrictions.[86]

Assignment or Transfer of Ownership of the Availability Fees

68. On August 17, 1998, Four Seasons Lakesites, Inc. assigned the availability fees to Roy and Cindy Slates.[87]

69. The 1998 and 1999 Annual Reports to the Commission for Four Seasons Water & Sewer Co. confirm that the company's stock was also transferred to the Slates.[88]

70. Following the August 17, 1998 assignment, neither Four Seasons Group, Inc. nor Four Seasons Lakesites, Inc. were involved with the billing or collection of availability fees assessed to the properties in Lake Region's service areas.[89]

71. On July 27, 1999, Lake Region filed its Annual Report with the Commission for the year ending December 31, 1998. Availability fees are listed as "other income" and total $52,648. This is consistent with timing of the assignment of the fees to the Slates. The 1998 Annual Report was the last year availability fees were reported to the Commission.[90]

72. On April 12, 2000, Roy and Cindy Slates assigned the availability fees to Lake Region Water & Sewer Company.[91]

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[86] *Joint Stipulation of Undisputed Facts,* No. 43.
[87] *Joint Stipulation of Undisputed Facts,* No. 44.
[88] *Joint Stipulation of Undisputed Facts,* No. 45.
[89] *Joint Stipulation of Undisputed Facts,* No. 46.
[90] *Joint Stipulation of Undisputed Facts,* No. 47.
[91] *Joint Stipulation of Undisputed Facts,* No. 48.

73. On April 12, 2000, Lake Region Water & Sewer Company assigned the availability fees to Waldo I. Morris.[92]

74. On October 13, 2004, Waldo I. Morris (President of Lake Region Water & Sewer Co.) and Robert P. Schwermann and Sally J. Stump executed a "Contract Regarding Availability Fees" ("Fee Contract").[93]

75. Part of the Fee Contract included consummating and closing a Stock Purchase Agreement (dated September 10, 2004) in which Robert P. Schwermann and Sally J. Stump purchased all of the stock in Lake Region for three million dollars.[94]

76. The Fee Contract was accompanied by a separate "Assignment of Availability Fees" agreement specifying that for the amount of $1.00, and "other good and valuable consideration," Mr. Morris assigned the availability fees to Robert P. Schwermann and Sally J. Stump.[95]

77. Robert P. Schwermann and Sally J. Stump hold the availability fees as tenants in common.[96]

78. On October 8, 2003, a lawsuit was initiated by Four Seasons Lakesites, Inc., contesting the ownership of the property rights for the availability fees; Civil Case No. CV103-760CC. The defendants in that lawsuit included Lake Region and Roy and Cindy Slates, and Waldo Morris, the former owners of Lake Region. On April 15, 2005, a confidential settlement was reached regarding who owned the property rights to the fees. This settlement included the assignment of availability fees from Waldo Morris to Robert P. Schwermann and Sally Stump. Sally J. Stump and RPS Properties, L.P. received

[92] *Joint Stipulation of Undisputed Facts,* No. 49.
[93] *Joint Stipulation of Undisputed Facts,* No. 50.
[94] *Joint Stipulation of Undisputed Facts,* No. 51.
[95] *Joint Stipulation of Undisputed Facts,* No. 52.
[96] *Joint Stipulation of Undisputed Facts,* No. 53.

the right to collect the availability fees as a result of that settlement; however, terms were put in place as to which party received what portion of the availability fees.[97]

79. Four Seasons Lakesites, Inc. holds a security interest in RPS Properties, L.P.'s and Sally Stump's availability fees as defined in the Collateral Assignment and Security Agreement dated April 15, 2005 and the Availability Fee Assessment rights as defined in the Collateral Assignment and Security Agreement dated April 15, 2005. This security interest includes all accounts, accounts receivable, payment intangibles, contract rights, chattel paper, instruments and documents and notes; all proceeds relating thereto; and all of the foregoing, which are related to or arising from such Availability Fees and the Availability Fee Assessment Rights.[98]

Collection and Amount of Availability Fees

80. According to the terms of the sales contract and the restrictive covenants for Four Seasons Lakesites, Inc. availability fees are levied on the owners of undeveloped lots. Once lots are developed, the owner of the property must connect to the water and sewage systems and availability fees are no longer charged once the connection is made and water and sewer service are being provided.[99]

81. Availability fees are not paid by Lake Region's water and sewer service customers.[100]

82. Lake Region must provide service to any property owner requesting service within Lake Region's service area, even if the property owner does not pay or is in arrears on paying the availability fees.[101]

[97] *Joint Stipulation of Undisputed Facts,* No. 54.
[98] *Joint Stipulation of Undisputed Facts,* No. 55.
[99] *Joint Stipulation of Undisputed Facts,* No. 56.
[100] *Joint Stipulation of Undisputed Facts,* No. 57.
[101] *Joint Stipulation of Undisputed Facts,* No. 58.

83. The number of annual bills for availability fees will vary while lots are sold and developed and will continue to vary annually until all lots are sold and developed.[102]

84. The actual amount of availability fees collected will vary based upon the property owners fulfilling their obligation to pay.[103]

85. The actual amount of availability fees collected annually will vary based upon when the property owners pay the fees.[104]

86. Depending on how quickly property owners develop their lots, some may pay availability fees for a very small number of months and some may pay the fees for years.[105]

87. The availability fee income that was reported to the Commission appears on line F-42 of the Annual Reports for "Other Income and Deductions."[106]

88. Since the sale of Lake Region's stock and the assignment of availability fees to Robert P. Schwermann and Sally J. Stump, and the settlement agreement executed in Civil Case No. CV103-760CC, Sally J. Stump and RPS Properties, L.P. have the right to collect the availability fees.[107]

89. RPS Properties, L.P. and Sally Stump d/b/a Lake Utility Availability 1 bills for and collects "availability fees" from land owners of undeveloped lots within the service area of the Lake Region. Lake Utility Availability 1 is a fictitious name registered with the Missouri Secretary of State.[108]

[102] *Joint Stipulation of Undisputed Facts,* No. 59.
[103] *Joint Stipulation of Undisputed Facts,* No. 60.
[104] *Joint Stipulation of Undisputed Facts,* No. 61.
[105] *Joint Stipulation of Undisputed Facts,* No. 62.
[106] *Joint Stipulation of Undisputed Facts,* No. 63.
[107] *Joint Stipulation of Undisputed Facts,* No. 64.
[108] *Joint Stipulation of Undisputed Facts,* No. 65.

90. Management fees for RPS Properties, L.P. and Vernon Stump are paid into the same account in which the availability fees are deposited. That account is titled Lake Utility Availability Fees and is owned by RPS Properties and Sally Stump.[109]

91. Billing statements for the availability fees bear the caption "Lake Utility Availability" and display the same address and phone number as a copy of a customer bill for water and sewer service from Lake Region.[110]

92. Cynthia Goldsby is currently a billing clerk employed by Camden County Public Water Supply District Number 4.[111]

93. Ms. Goldsby's hourly wage is paid by Camden County PWSD4 and is $14.44.[112]

94. As part of Ms. Goldsby's job responsibilities, she provides billing and collection services for Lake Region.[113]

95. Also as part of Ms. Goldsby's job responsibilities, she handles billing and collection of the availability fees, but in a 2010 sworn affidavit she stated she did not have information sufficient to state with certainty that the billing and collection of availability fees was on behalf of RPS Properties or some other entity or entities.[114]

96. RPS Properties, L.P. makes no payments for Ms. Goldsby's services. RPS Properties, L.P. makes no payments to the Camden County PWSD4 for Ms. Goldsby's services.[115]

97. Ms. Goldsby currently sends bills for annual availability fees to 1,322 individuals or entities owning Shawnee Bend properties.[116]

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[109] *Joint Stipulation of Undisputed Facts,* No. 66.
[110] *Joint Stipulation of Undisputed Facts,* No. 67.
[111] *Joint Stipulation of Undisputed Facts,* No. 68.
[112] *Joint Stipulation of Undisputed Facts,* No. 69.
[113] *Joint Stipulation of Undisputed Facts,* No. 70.
[114] *Joint Stipulation of Undisputed Facts,* No. 71.
[115] *Joint Stipulation of Undisputed Facts,* No. 72.

98. The annual availability fees for both water and sewer for each entity billed is $300.[117]

99. RPS Properties, L.P. and Sally Stump began collecting availability fees in 2005, but they retain only a portion of the availability fees pursuant to the April 15, 2005 settlement agreement in Civil Case No. CV103-760CC.[118] The availability fees are currently divided among RPS Properties, L.P., Sally Stump, and Four Seasons Lakesites, Inc. pursuant to the terms of that settlement agreement.[119]

Historical Treatment of Availability Fees

100. The Commission has had a number of cases come before it in the past that have dealt with issues concerning availability fees. Those issues involved determinations regarding whether the fees constitute regulated utility services and how to treat the revenue derived from fees.[120]

101. In Case No. WR-92-59, where Lakesites Water & Sewer Company (Lake Region's predecessor) sought an increase in rates, the availability fees were removed from the general revenue stream and the rate base was reduced a certain amount as an offset for the reduction in general revenue related to the availability fees. This case was settled with a unanimous agreement from the parties that the Commission approved.[121]

102. In Case No. WR-99-193, where Ozark Shores sought an increase in rates, the parties agreed to add availability fees into the general revenue stream of the company and add additional rate base to the company as an offset. The availability fees are included

[116] *Joint Stipulation of Undisputed Facts,* No. 73.
[117] *Joint Stipulation of Undisputed Facts,* No. 74.
[118] *Joint Stipulation of Undisputed Facts,* No. 75.
[119] Transcript, Vol. VIII, p. 213.
[120] *Joint Stipulation of Undisputed Facts,* No. 76.
[121] *Joint Stipulation of Undisputed Facts,* No. 77.

in utility rates and are not tariffed. This case was settled with a unanimous agreement from the parties that the Commission approved.[122]

103. Peaceful Valley Service Company, a wholly owned subsidiary of Peaceful Valley Property Owners Association, collects availability charges as general revenue to reserve access to its water service and the fees are tariffed. Peaceful Valley's tariff provision applies to availability charges that are generated through a contract between the property owner and the company, or from a contract between a property owner and a developer that was assigned to the utility company. The treatment of the availability fees stemmed from a unanimous agreement from the parties that the Commission approved.[123]

104. I.H. Utilities formerly collected availability fees as general revenue and these charges were tariffed in rates. The fees originated in a contract between the developer and the property owner that was later assigned to the company. I.H. Utilities no longer collects the fees and they are no longer tariffed in rates.[124]

105. Lake Region is the only water or sewer utility regulated by the Commission that has not treated availability fees as utility revenue.[125]

106. The Commission's Staff has been aware of the availability fees being charged to the property owners in the Shawnee Bend area since Commission Case No. WA-95-164, the certificate case for Lake Region's predecessor.[126]

107. Lake Region does not collect availability fees or book those fees into any of its accounts.[127] Those fees have never been included in Lake Region's tariffs.[128]

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[122] *Joint Stipulation of Undisputed Facts,* No. 78.
[123] *Joint Stipulation of Undisputed Facts,* No. 79.
[124] *Joint Stipulation of Undisputed Facts,* No. 80.
[125] Transcript, Vol. VIII, p. 308-9, 318.
[126] *Joint Stipulation of Undisputed Facts,* No. 81.
[127] Transcript, Vol. VIII, p. 233.
[128] Transcript, Vol. VIII, p. 288-89.

108. Lake Region annual reports provided to the Commission from approximately 1974-1998 that mention availability fees are not accurate because data is missing from some reports. The reports also fail to distinguish between the Shawnee Bend and Horseshoe Bend areas, including areas currently served by Ozark Shores and not involved in this case.[129]

109. Lake Region has provided good service to its customers and is not a problem company.[130]

The 2010 rate case

110. In the last rate case for Lake Region Water and Sewer Company, the Commission issued its Report and Order on August 18, 2010.[131] The 2010 Lake Region rate case involved the presentation of evidence relating to availability fees, and the Report and Order, which was approved by the Commission, considered whether it had jurisdiction over the availability fees and how to treat those fees in light of the Commission's history of previous actions.

111. To determine its jurisdiction, the Commission examined the definition of utility "service" in Section 386.020(48), RSMo Supp. 2013.[132] The Commission concluded that availability fees could be construed to be a "commodity" under the definition of "service" and that it should assert jurisdiction over those fees. However, the Commission noted that such a determination would be a substantial departure from past Commission decisions,

[129] Transcript, Vol. VIII, p. 252-53, 330.
[130] Transcript, Vol. VIII, p. 301-2.
[131] In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water and Sewer Service, File Nos. WR-2010-0111 and SR-2010-0110, *Report and Order,* issued August 18, 2010.
[132] "Service" includes not only the use and accommodations afforded consumers or patrons, but also any product or commodity furnished by any corporation, person or public utility and the plant, equipment, apparatus, appliances, property and facilities employed by any corporation, person or public utility in performing any service or in furnishing any product or commodity and devoted to the public purposes of such corporation, person or public utility, and to the use and accommodation of consumers or patrons".

policy and practice and was contrary to Staff's expert testimony. It is important to note that the Commission stopped short of making a specific finding of fact or conclusion of law that availability fees are a commodity.[133]

112. In looking at the Commission's history in relation to availability fees in the 2010 Report and Order, the Commission found that for over 37 years it had treated Lake Region's fees as not being a utility service and not within its jurisdiction, regulation or control. The Commission concluded that it would be inappropriate to change its previous interpretation in an adjudicated order and that such a major policy shift should occur instead through the process of administrative rulemaking.[134] The availability fees were not imputed as revenue to Lake Region in that 2010 Report and Order.

113. The Commission subsequently opened workshop dockets on August 23, 2010 in File Nos. WW-2011-0043 and SW-2011-0042, in order to explore options for the ratemaking treatment of availability fees and formalize a proper policy in a later rulemaking.[135] No formal action was taken in those matters until June 16, 2011 when the Commission consolidated the workshop dockets with another more general proceeding, File No. WW-2009-0386, which had been instituted to investigate solutions to problems facing small water and sewer companies.[136] Staff received comments and conducted workshops and meetings with interested parties on a number of topics, but ultimately consensus was not reached on most issues and nothing was proposed to address

[133] See, *Order Regarding Motions for Rehearing, Motion for Reconsideration and Request for Clarification*, p. 2, File Nos. WR-2010-0111 and SR-2010-0110, issued September 1, 2010.
[134] Report and Order, WR-2010-0111 and SR-2010-0110, at p.105-106.
[135] In the Matter of a Working Case to Investigate Appropriate Methods for Ratemaking Treatment of Fees or Other Mechanisms Used for Capital Recovery of Sewer and Water Infrastructure Investment, File Nos. SW-2011-0042 and WW-2011-0043, *Order Directing Notice of Working Case and Directing Filing,* issued August 23, 2010.
[136] In the Matter of a Working Case to Investigate Solutions to Problems Facing Small Water and Sewer Public Utilities, File No. WW-2009-0386, *Order Consolidating Investigations,* issued June 16, 2011.

availability fees.[137] The Commission closed the file on January 23, 2013, and no action has since been taken to initiate proposed rulemaking regarding availability fees.[138]

114. The 2010 Report and Order required Lake Region to file a new rate case within three years from that previous order. In compliance with that order, Lake Region has now filed the current rate case that is before the Commission. On November 15, 2013, Staff filed direct testimony asserting that estimated availability fees should be imputed to Lake Region as revenue when calculating the company's revenue requirement.[139] The Office of Public Counsel filed direct testimony alleging that availability fees should be considered as contributions in aid of construction and included as an offset to Lake Region's rate base.[140] Thus, the Commission is now presented in this case with the same availability fee issue that it considered in the 2010 rate case.

Conclusions of Law and Decision

Lake Region objections to Staff and Public Counsel availability fee evidence

As a preliminary matter with regard to the issue of availability fees, the Commission must first rule on evidentiary objections by Lake Region to portions of Staff and OPC's witness testimony and exhibits that mention availability fees.[141] During the hearing, the regulatory law judge reserved a ruling on those objections and stated that the Commission would take the objections with the case. Lake Region's arguments supporting the

[137] Lake Region Ex. 2, Summers Rebuttal, p. 2-4.
[138] In the Matter of a Working Case to Investigate Solutions to Problems Facing Small Water and Sewer Public Utilities, File No. WW-2009-0386, *Order Granting Motion to Close File,* issued January 23, 2013; Transcript, Vol. VIII, p. 278.
[139] Staff Ex. 3, Bolin Direct, p. 13; Staff Ex. 1, Report on Revenue Requirement-Cost of Service, p. 14-16.
[140] OPC Ex. 2, Robertson Direct, p. 3-8.
[141] Transcript, Vol. VIII, p. 221-225; 264; 319-321; 347-348; 352; *Lake Region Water & Sewer Company's Objections to Hearing* Exhibits, filed March 6, 2014.

objections were filed previously in Lake Region's evidentiary motions.[142] Therefore, the initial issue for determination is whether to sustain or overrule those objections.

Lake Region's position is that availability fees are beyond the jurisdiction of the Commission, so any evidence regarding those fees should be excluded from the record because it is irrelevant to the case. The parties in this case (except for Staff) and the 2010 Report and Order have all based their arguments regarding jurisdiction on the definition of "service" in Section 386.020(48), RSMo Supp. 2013. However, it is not necessary or even relevant to consider the meaning of "service".

The words in Section 386.020 are just definitions and do not confer or deny any authority by themselves. To be pertinent here, the word "service" must be used in a statute that relates to the Commission's jurisdiction or statutory authority. Lake Region argues that "service" is important because it appears in Section 386.250(6), RSMo 2000, which states that:

> The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter:
>
> ***
>
> (6) To the adoption of rules as are supported by evidence as to reasonableness and which prescribe the conditions of rendering public utility service, disconnecting or refusing to reconnect public utility service and billing for public utility service. All such proposed rules shall be filed with the secretary of state and published in the Missouri Register as provided in

[142] On November 22, 2013, Lake Region filed a *Motion to Strike Portions of the Written Testimony of Staff Witness Kim Bolin and Sections of Staff's Revenue Requirement and Cost of Service Report,* a *Motion to Strike Portions of the Written Testimony of Ted Robertson, Witness for the Office of Public Counsel*, and a *Motion in Limine*. These evidentiary motions were in response to the direct testimony filed by Staff and OPC and contend that: 1) the Commission does not have jurisdiction over availability fees, 2) it is unlawful to impute those fees as revenue to Lake Region without a definitive administrative rule, 3) evidence pertaining to the fees is irrelevant because the previous report and order concluded that those fees should not be considered imputed revenue to Lake Region, 4) certain references to availability fees in the testimony filed by Staff and OPC should be stricken, and 5) Staff and OPC should be barred from conducting further discovery or presenting any evidence at a hearing regarding availability fees. The Commission denied the motions on December 18, 2013 because they were premature and directed that any objections be made during the hearing.

> chapter 536, and a hearing shall be held at which affected parties may present evidence as to the reasonableness of any proposed rule;

This statute gives the Commission the authority to promulgate administrative rules relating to utility service. However, the Commission has not adopted any rules regarding availability fees and is not attempting to do so in this case. Promulgating a rule describing how a utility service should be rendered is different than considering a source of revenue when setting utility rates. Therefore, this statutory provision is not relevant here, and the Commission need not analyze the definition of "service" in determining its jurisdiction.

The Commission has personal jurisdiction over Lake Region because it is a water and sewer corporation and a public utility.[143] The Commission has subject matter jurisdiction because Lake Region filed a rate case.[144] Consequently, the Commission's jurisdiction is clear, and the only real question is whether the Commission has the statutory authority to consider the availability fees in determining whether Lake Region's proposed rate increase is just and reasonable. In deciding whether the rate proposed is appropriate, the Commission can consider any facts it determines to be relevant.[145] Moreover, Missouri's prohibition against single-issue ratemaking bars the Commission from allowing a public utility to change an existing rate without consideration of all relevant factors, such as operating expenses, revenues, and rates of return.[146] Lake Region's revenue is relevant to its rate case, and whether the availability fees were included as part of Lake Region's revenue prior to 1998 is one of the disputed facts in this case. So, the Commission has statutory authority to consider whether Lake Region's revenue included availability fees in

[143] *Joint Stipulation of Additional Material Undisputed Facts*, No. 1.
[144] See, Sections 393.140(11) and 393.150, RSMo 2000.
[145] Section 393.270.4, RSMo 2000.
[146] *State ex rel. Mo. Water Co. v. Public Service Commission,* 308 S.W.2d 704, 718-19 (Mo. 1957); *State ex rel. Util. Consumers Council of Mo., Inc. v. Pub. Serv. Comm'n,* 585 S.W.2d 41, 56-58 (Mo.banc 1979).

the past and, if so, whether such revenue should be imputed to Lake Region in the future in setting Lake Region's rates.

Lake Region also argues that the Commission's promulgation of an administrative rule regarding availability fees is a condition precedent to the Commission's consideration of those fees. Since no such rule has been proposed or adopted, Lake Region asserts that the Commission does not have the jurisdiction to consider availability fees in this case. This argument is not persuasive. Based on the evidentiary record in the 2010 Rate Case, the Commission concluded at that time that asserting jurisdiction over availability fees would constitute a prospective "statement of general applicability that implements, interprets, or prescribes law or policy".[147] However, the Commission must now make a determination based on the evidentiary record presented in this case, which is similar, but not identical to, the record in the 2010 Rate Case.[148] The preponderance of the evidence in this case indicates that resolving the issue of availability fees does not involve enacting general policy for all water and sewer companies. Lake Region's situation is unique in that the availability fees were assigned to other entities or persons and not provided to the utility for maintenance or repairs. There is evidence in the record that, unlike Lake Region, three other utilities which have or had availability fees retained that revenue with the utility and did not assign it. Since Lake Region's situation can be distinguished from those other utilities, an order resolving this particular availability fee issue applies only to this specific fact situation. Based on the record of this case, the appropriate action is an adjudication

[147] Report and Order, WR-2010-0111 and SR-2010-0110, at p.104; See, Section 536.010(6), RSMo Supp. 2013.

[148] In addition, an administrative agency is not bound by stare decisis, nor are agency decisions binding precedent on the Missouri courts. *State ex rel. AG Processing, Inc. v. Public Serv. Comm'n*, 120 S.W.3d 732, 736 (Mo. banc 2003). The mere fact that an administrative agency departs from a policy expressed in prior cases which it has decided is no ground alone for a reviewing court to reverse the decision. *Columbia v. Mo. State Bd. of Mediation*, 605 S.W.2d 192, 195 (Mo. App. 1980).

rather than rulemaking.[149] The Commission concludes that it has the statutory authority to consider availability fees and that the evidence presented at the hearing is relevant to resolving that issue through adjudication. Therefore, the Commission will overrule Lake Region's objections to the availability fee evidence presented in the hearing.

Treatment of availability fees

The Commission must determine whether availability fees collected from owners of undeveloped lots in Lake Region's service territory should be classified as Lake Region revenue or applied against rate base. Staff's position is that availability fees collected going forward should be imputed as revenue to Lake Region, although Lake Region does not currently receive any of those funds. Public Counsel asserts that availability fees should be applied against rate base as contributions in aid of construction. Lake Region opposes both of these positions.

Staff has proposed two arguments why the availability fees should be imputed as revenue to Lake Region. First, Staff alleged in its pre-filed testimony and during the hearing that the assignment of the availability fee revenue in 1998 to shareholders of the company by Lake Region was imprudent. Second, Staff states that the assignment of availability fees to shareholders in 1998 constituted an illegal act that is void as a matter of law because it was not approved by the Commission. Staff alleges that the assignment violated Section 393.190.1, RSMo 2000, which prohibits a water or sewer corporation from selling or assigning "any part of its franchise, works or system" without Commission

[149] In contrast to a rule, an adjudication is "[a]n agency decision which acts on a specific set of accrued facts and concludes only them." *HTH Companies, Inc. v. Missouri Dept. of Labor and Indus. Relations*, 157 S.W.3d 224, 228 -229 (Mo. App. 2004).

approval.[150] Both arguments are based on the assumption that Lake Region received or had use of the availability fees at the time of the assignment.

As the party requesting the rate increase, Lake Region bears the burden of proving that its proposed rate increase is just and reasonable.[151] The issue of availability fees was first introduced into the case when Staff and Public Counsel submitted testimony concerning that issue after Lake Region filed its proposed tariff and direct testimony. Since these assertions concerning availability fees do not involve an element of Lake Region's case, but rather present a new issue not depending on the truth of Lake Region's allegations, Staff and Public Counsel's arguments are analogous to an affirmative defense, such as fraud or illegality.[152] As the parties asserting that availability fees should be included in the determination of Lake Region's rates, Staff and Public Counsel bear the burden of producing evidence to support those allegations.[153]

There is evidence that it was the developer's intent when the restrictive land covenants were created in the 1970s that those availability fees would be paid to a water and sewer company certificated by the Commission and included in approved rates, but those fees were never included in Lake Region's rates. The annual reports provided to the

[150] This theory was not previously identified as an issue by the parties, and Lake Region was not provided an opportunity to present any evidence on it, which it was entitled to do as a matter of due process. However, because of the Commission's ultimate decision on this issue the Commission will address the substance of Staff's argument.

[151] Section 393.150.2, RSMo 2000.

[152] Mo. Sup. Ct. R. 55.08 states "[i]n pleading to a preceding pleading, a party shall set forth all applicable affirmative defenses and avoidances, including but not limited to accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, comparative fault, state of the art as provided by statute, seller in the stream of commerce as provided by statute, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant, laches, license, payment, release, res judicata, statute of frauds, statute of limitations, truth in defamation, waiver, and any other matter constituting an avoidance or affirmative defense. A pleading that sets forth an affirmative defense or avoidance shall contain a short and plain statement of the facts showing that the pleader is entitled to the defense or avoidance. When a party has mistakenly designated a defense as a counterclaim or a counterclaim as a defense, the court may treat the pleadings as if there had been a proper designation." (emphasis added) See also, Black's Law Dictionary (6th ed. 1990), which defines affirmative defense as a "matter asserted by defendant which, assuming the complaint to be true, constitutes a defense to it."

[153] *Ozark Air Lines, Inc. v. Valley Oil Co., L.L.C.*, 239 S.W.3d 140, 145 (Mo. Ct. App. 2007); *Kansas City Power & Light Co. v. Bibb & Associates, Inc.*, 197 S.W.3d 147, 156 (Mo. Ct. App. 2006).

Commission from approximately 1974-1998 that mention availability fees are not accurate because data is missing from some reports and are not reliable because the reports fail to distinguish between the Shawnee Bend and Horseshoe Bend areas, including areas currently served by Ozark Shores and not involved in this case. There is an indication that Lake Region's predecessor may have received availability fees in 1992[154], but Staff and Public Counsel did not explore this further or present any evidence on this point. Staff alleges that the assignment of the availability fee revenue to the Lake Region shareholders was imprudent, but presented no evidence about the specific details of the assignment, the reasons for or against that action, why the assignment was improper, or how it resulted in harm to the ratepayers. There is support in the record for Lake Region's position that Lake Region did not receive any availability fees at the time of the assignment in 1998. A fact stipulated by all the parties stated that in 1998 the developer, not Lake Region, assigned the availability fees to the shareholders of Lake Region.[155] If Lake Region had been receiving the availability fees at that time, it should have at least been a party to the assignment.

Even assuming that Lake Region's predecessor did receive availability fees prior to 1998, there was no evidence presented concerning the company's use of availability fees during the early years before the assignment, other than the one stipulated fact that "the purpose for establishing the availability fees was to recover the investment in the water and sewer systems, not to maintain or repair the existing operations of the systems once they were constructed".[156] If Lake Region's predecessor received the availability fee revenue prior to 1998, it is unclear whether the company had the full use of those funds for utility

[154] *Joint Stipulation of Undisputed Facts,* No. 77.
[155] *Joint Stipulation of Undisputed Facts,* No. 44.
[156] *Joint Stipulation of Undisputed Facts,* No. 42.

purposes or whether it only acted as a conduit for reimbursing the developer for the construction costs of the water and sewer systems. The Commission concludes that Staff has not presented sufficient evidence to show that Lake Region or its predecessor imprudently assigned the availability fees to its shareholders in 1998 or used that revenue for utility purposes, thus making the fees a part of Lake Region's "franchise, works or system" at the time of the fee assignment.

While Public Counsel agrees with Staff that availability fees should be accounted for in setting rates, it does not believe that Staff's proposal of imputing revenue to Lake Region is reasonable because it would unjustly benefit shareholders by maintaining a higher rate base on which shareholder returns are calculated. Public Counsel recommends instead that the Commission apply availability fees against rate base as contributions in aid of construction ("CIAC"), which are donations or contributions of cash, service or property to a utility for purposes of construction. Public Counsel estimated that the availability fees collected far exceed the amount of the contributions already donated as CIAC by the developer for system construction and argues that these excess fees should also be treated as CIAC and further reduce Lake Region's rate base. However, the Commission finds Lake Region's evidence that it would take 45 years for the availability fees to fully reimburse the developer for the donated infrastructure to be more credible than Public Counsel's estimates. This indicates that the lot owners have not yet paid any excess fees that would justify reducing Lake Region's rate base.

In addition, the Commission determines it would be unjust and unreasonable for the Commission to adopt either Staff's or Public Counsel's recommendations. Either approach would deny the developer or its successors the opportunity to recover the original donated investment. This would also unfairly give the customers the double benefit of having part of

the plant contributed, but then reducing rates through imputing fictitious revenue or further reducing rate base. It would be incorrect to assume that Lake Region can force the current beneficiaries of the availability fees (some of whom are not shareholders) to return those funds to the company in response to a Commission order. If Lake Region were to fail in that attempt, the company may suffer a revenue shortfall below its cost of service, which could have dramatic negative consequences to its financial viability. For all of the reasons stated above, the Commission concludes that availability fees collected from owners of undeveloped lots in Lake Region's service territory should not be classified as Lake Region revenue or applied against rate base.

B. Capital Structure

Findings of Fact

115. Lake Region is owned by RPS Properties, L.P. and Vernon Stump.[157] Vernon Stump acquired his shares in Lake Region from his wife, Sally Stump, on December 31, 2012.[158] RPS Properties, L.P. is a limited partnership for the Schwermann family with Robert Schwermann as the general partner.[159]

116. In the 2010 rate case, all of the debt associated with Lake Region was debt of the then existing Lake Region shareholders with Alterra Bank as the lender ("shareholder loan"), and the parties to that rate case agreed that Lake Region should be considered to have a capital structure of 100% debt.[160]

117. The shareholder loan was used in the acquisition of Lake Region and has been refinanced several times.[161]

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[157] Staff Ex. 1, Report on Revenue Requirement-Cost of Service, p. 2; Transcript, Vol. VIII, p. 261.
[158] *Id*; Transcript, Vol. VIII, p. 167.
[159] Staff Ex. 1, Report on Revenue Requirement-Cost of Service, p. 5.
[160] Staff Ex. 1, Report on Revenue Requirement-Cost of Service, p. 6-7; Staff Ex. 7, Atkinson Surrebuttal, p. 2-3.
[161] Staff Ex. 1, Report on Revenue Requirement-Cost of Service, p. 5-6; Transcript, Vol. VIII, p. 165.

118. In 2011, Alterra Bank required a negative pledge agreement on the shareholder loan, in which the shareholders agreed not to pledge as collateral any of the assets of Lake Region on any other indebtedness.[162] Other than the negative pledge agreement, the notes and pledge agreements for the shareholder loan do not mention Lake Region assets.[163] Alterra Bank later released the negative pledge agreement on the shareholder loan, and it was no longer in force as of January 1, 2014.[164]

119. That shareholder loan is secured by the shareholders' shares of stock, but is not currently secured by any Lake Region utility assets.[165] The shares of stock are not considered to be assets of Lake Region for accounting purposes.[166]

120. In 2012, Lake Region filed a financing application with the Commission in order to re-structure the company's finances to show approximately 60% debt and 40% equity.[167] With the approval of the Commission in File No. WF-2013-0118, Lake Region took out a loan from Alterra Bank in the amount of approximately $1.4 million ("Lake Region loan"), which was used to repurchase common equity from Lake Region's shareholders and was secured by the company's utility assets and cash flow.[168]

121. The current amount of the Lake Region loan is approximately $1.4 million and the remaining amount of the shareholder loan is approximately $1.3 million.[169]

122. Lake Region's actual capital structure is 60% debt and 40% equity.[170]

123. Staff used a Small Utility Return on Equity (ROE)/Rate of Return (ROR) Methodology ("methodology") to develop a hypothetical capital structure, target bond rating,

[162] Lake Region Ex. 7, Alterra Bank/RPS loan documents; Transcript, Vol. VIII, p. 170.
[163] Transcript, Vol. VIII, p. 187.
[164] Lake Region Ex. 2, Summers Rebuttal, p. 13-14; Lake Region Ex. 6; Transcript, Vol. VIII, p. 188.
[165] Lake Region Ex. 7, Alterra Bank/RPS loan documents; Lake Region Ex. 2, Summers Rebuttal, p. 12-13.
[166] Transcript, Vol. VIII, p. 176.
[167] Lake Region Ex. 2, Summers Rebuttal, p. 12.
[168] Staff Ex. 1, Report on Revenue Requirement-Cost of Service, p. 4-5; Transcript, Vol. VIII, p. 167-168.
[169] *Id.*
[170] Lake Region Ex. 2, Summers Rebuttal, p. 12.

and estimated return on equity.[171] Staff's reasonable methodology is a transparent and verifiable method for establishing a capital structure and measurement of a fair return on equity.[172]

124. Staff's methodology calls for the use of a hypothetical capital structure that limits debt to 75% of total capital in situations where a small water and sewer company has debt capital in excess of 75%.[173]

125. Staff' methodology demonstrates that Lake Region's actual capital structure is consistent with the level of business and financial risk associated with a company such as Lake Region.[174]

126. Regulatory recognition of Lake Region's actual capital structure makes it easier for Lake Region to obtain more favorable terms from lenders in the future when refinancing existing loans or securing additional capital.[175]

Conclusions of Law and Decision

The primary issue in determining Lake Region's appropriate capital structure is whether to apply the company's actual capital structure or a hypothetical capital structure. Both Lake Region and Public Counsel argue that the capital structure for Lake Region should be based on its actual capital structure, but Staff disagrees with that position.

Staff states that a hypothetical capital structure should be used for Lake Region, based on its conclusion that the company is financed with 100% debt. Staff reaches this conclusion because it includes in its calculation of company debt the shareholder loan. Staff considers the shareholder loan to be company debt because it believes that in the

[171] Staff Ex. 1, Report on Revenue Requirement-Cost of Service, Appendix 2, Schedule SA-1.
[172] Lake Region Ex. 5, Gorman Rebuttal, p. 3.
[173] Staff Ex. 1, Report on Revenue Requirement-Cost of Service, Appendix 2, Schedule SA-1, p. 4.
[174] Lake Region Ex. 5, Gorman Rebuttal, p. 2-11; Transcript, Vol. VIII, p. 150-51.
[175] Transcript, Vol. VIII, p. 158.

event of a default of the shareholder loan, the lending bank would take control of the utility's assets. In situations where a small water and sewer utility has debt in excess of 75% of capital, Staff believes it is appropriate to use a hypothetical capital structure that limits debt to 75% of total capital.

Staff's assumption that the shareholder loan is debt of the company is incorrect. The shareholders pledged their shares of stock in the company as security for the loan, but did not pledge the actual utility assets. In the event of a default, the lending bank would take control of the company stock, not the utility assets. Staff's position that the Lake Region loan and the shareholder loan should all be considered to be company debt requires that the corporate form of Lake Region be disregarded. A corporation such as Lake Region is a legal entity separate and distinct from its owners.[176] Courts look to the corporation, not the shareholders, in determining the corporation's rights and duties in respect to third parties unless the owners use the corporate form to engage in wrongful conduct.[177] One of the rare circumstances where the corporate form is disregarded is when a corporation is so dominated by a person as to be an alter ego of that person. In that case the two are treated as one, which is known as "piercing the corporate veil".[178] This theory is usually used when a third party is attempting to reach a shareholder's assets in litigation with a corporation. Staff's position is, in effect, a reverse pierce by using the shareholders' debts to affect the debt of the company. However, Staff has presented no evidence of fraud or

[176] *Forest City Mfg. Co. v. International Ladies' Garment Workers' Union, Local No. 104,* 111 S.W.2d 934, 940 (Mo. App. E.D. 1938).
[177] *Commerce Trust Co. v. Woodbury,* 77 F.2d 478, 487 (8th Cir. 1935).
[178] *Collet v. Am. Nat. Stores, Inc.*, 708 S.W.2d 273, 284 (Mo. Ct. App. 1986). In order to pierce the corporate veil, a party must show: (1) Control, not mere majority or complete stock control, but complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and (2) Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or dishonest and unjust act in contravention of plaintiff's legal rights; and (3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.

wrongful conduct to justify disregarding Lake Region's corporate form and treating the shareholder loan as company debt. Therefore, the shareholder loan should not be considered in calculating Lake Region's amount of debt.

Since Lake Region's debt capital is less than 75%, according to Staff's reasonable methodology the use of a hypothetical capital structure is not appropriate. That methodology demonstrates that use of the actual capital structure of 60% debt and 40% equity is reasonable and benefits the company and its customers by lowering its cost of refinancing and obtaining additional capital in the future. The Commission concludes that the capital structure for Lake Region should be based on its actual capital structure of 60% debt and 40% equity.

C. Return on Equity

Findings of Fact

127. Staff used the same methodology for determining capital structure in order to estimate Lake Region's cost of common equity.[179] The methodology applies a standard risk premium to a reasonable estimate of the current cost of debt for Lake Region to arrive at an estimated return on equity.[180]

128. At a 60% level of debt capital, Staff's methodology indicates that Lake Region's financial risk profile would be on the threshold between "Aggressive" and "Highly Leveraged". That financial risk profile, when applied to Standard & Poor's *Criteria Methodology: Business Risk/Financial Risk Matrix Expanded*, would support a credit rating

[179] Staff Ex. 1, Report on Revenue Requirement-Cost of Service, p. 7.
[180] *Id.* at Appendix 2, Schedule SA-1, p. 2.

that is approximately two notches higher than what Staff had used for its more leveraged capital structure recommendation.[181]

129. At a 60% level of debt capital, Staff's methodology supports Staff's alternative return on equity for Lake Region of 11.93%.[182]

Conclusions of Law and Decision

In order to set a fair rate of return for Lake Region, the Commission must determine the weighted cost of each component of the utility's capital structure. The component at issue in this case is the estimated cost of common equity, or the return on equity. Estimating the cost of common equity capital is a difficult task, as academic commentators have recognized.[183] Determining a rate of return on equity is imprecise and involves balancing a utility's need to compensate investors against its need to keep prices low for consumers.[184]

Missouri court decisions recognize that the Commission has flexibility in fixing the rate of return, subject to existing economic conditions.[185] "The cases also recognize that the fixing of rates is a matter largely of prophecy and because of this commissions in carrying out their functions necessarily deal in what are called 'zones of reasonableness' the result of which is that they have some latitude in exercising this most difficult

[181] Staff Ex. 7, Atkinson Surrebuttal, p. 9; Staff Ex. 1, Report on Revenue Requirement-Cost of Service, Appendix 2, Schedule SA-3.
[182] Staff Ex. 7, Atkinson Surrebuttal, p. 9.
[183] See Phillips, *The Regulation of Public Utilities*, Public Utilities Reports, Inc., p. 394 (1993).
[184] *State ex rel. Pub. Counsel v. Pub. Serv. Comm'n*, 274 S.W.3d 569, 574 (Mo. Ct. App. 2009).
[185] *State ex rel. Laclede Gas Co. v. Public Service Commission*, 535 S.W.2d 561, 570-571 (Mo. App. 1976).

function."[186] Moreover, the United States Supreme Court has instructed the judiciary not to interfere when the Commission's rate is within the zone of reasonableness.[187]

In this case Staff and Lake Region agree that Staff's methodology for estimating a return on equity is reasonable, but differ on the result after applying the procedure. Staff believes that at a 60% level of debt capital the methodology supports a return on equity of 11.93%. Lake Region argues for the higher return of 13.89%, which Staff originally proposed for its hypothetical capital structure of 75% debt capital. Public Counsel recommends that Lake Region's return on equity should be set at 8.5%, which was the return awarded to Lake Region in the 2010 rate case.

The Commission determines that a fair and reasonable return on equity for Lake Region is 11.93%. Public Counsel's recommendation is not persuasive because it did not provide sufficient financial analysis to demonstrate that its recommended return is consistent with current market costs or would support Lake Region's financial integrity and access to capital markets. The Commission's determination that Lake Region's capital structure is 60% debt is a reduction from Staff's original proposal of 75% debt. This reduction in debt results in less financial risk for Lake Region's investors and supports a lower return on equity without compromising Lake Region's ability to attract investors and capital. The Commission concludes that a return on equity for Lake Region of 11.93% constitutes a reasonable balance between the interests of ratepayers and the utility's shareholders.

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[186] *State ex rel. Laclede Gas Co. v. Public Service Commission*, 535 S.W.2d 561, 570 -571 (Mo. App. 1976). In fact, for a court to find that the present rate results in confiscation of the company's private property, that court would have to make a finding based on evidence that the present rate is outside of the zone of reasonableness, and that its effects would be such that the company would suffer financial disarray. *Id*.

[187] *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 574 (Mo. App. 2009). *See, In re Permian Basin Area Rate Cases,* 390 U.S. 747, 767, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968) ("courts are without authority to set aside any rate selected by the Commission [that] is within a 'zone of reasonableness' ").

D. Legal Fees

Findings of Fact

130. In 2009, Shawnee Bend Development Company, LLC ("SB Development") filed a civil action against Lake Region in the circuit court of Camden County, Missouri. SB Development alleged that Lake Region breached a 1998 contract and sought damages for alleged nonpayment of sums due for constructing a road crossing, a sewer trunk extension line and a well.[188]

131. The circuit court judge agreed with Lake Region's position, but SB Development appealed to the Southern District Court of Appeals.[189]

132. On appeal, the Southern District Court of Appeals agreed with SB Development and reversed the trial court in favor of SB Development.[190]

133. Lake Region participated in the appeal of the case to protect the trial court judgment in its favor in order to avoid increased costs should the judgment be reversed.[191]

134. Lake Region incurred non-recurring legal fees in defending the circuit court case and participating in the appeal.[192] Lake Region incurred an additional $520.10 in legal fees during the true-up period in pursuit of an application for transfer of the case to the Supreme Court.[193]

Conclusions of Law and Decision

In rate cases, there is initially a presumption that a utility's expenditures incurred in providing utility service, which are one component of its revenue requirement, are

[188] Lake Region Ex. 2, Summers Rebuttal, p. 15.
[189] *Id.*
[190] *Id.* at p. 17; Transcript, Vol. VIII, p. 344.
[191] *Id.* at p. 18.
[192] *Id.*
[193] *Unanimous Partial Stipulation and Agreement as to True-Up Issues,* paragraph 3(b), filed March 17, 2014 and approved by Commission order issued March 26, 2014.

prudent.[194] This presumption can be rebutted upon a showing of serious doubt as to the prudence of the expenditure, at which point the utility must dispel this doubt and prove the questioned expenditure is prudent.[195] The Commission has interpreted this process as follows:

> In the context of a rate case, the parties challenging the conduct, decision, transaction, or expenditures of a utility have the initial burden of showing inefficiency or improvidence, thereby defeating the presumption of prudence accorded the utility. The utility then has the burden of showing that the challenged items were indeed prudent. Prudence is measured by the standard of reasonable care requiring due diligence, based on the circumstances that existed at the time the challenged item occurred, including what the utility's management knew or should have known. In making this analysis, the Commission is mindful that "[t]he company has a lawful right to manage its own affairs and conduct its business in any way it may choose, provided that in so doing it does not injuriously affect the public.[196]

Lake Region incurred the legal expenses at issue defending a position that would have allowed the company to avoid increased costs. If Lake Region had ultimately been successful, it would have had to pay less money to SB Development regarding the 1998 contract dispute. The fact that Lake Region did not prevail on appeal does not make its decision to participate in the appeal imprudent, especially considering that Lake Region was successful at the circuit court level. Lake Region pursued a reasonable course of action by participating in the appeal of this case in an attempt to avoid increased costs. The Commission concludes that the legal fees incurred by Lake Region in defending the circuit court case and participating in the appeal, including the $520.10 incurred during the

[194] *State ex rel. Public Counsel v. Public Service Comm'n*, 274 S.W.3d 569, 586 (Mo. App. 2009).
[195] *Id*.; *State ex rel. Associated Natural Gas Company v. Public Service Commission of the State of Missouri,* 954 S.W.2d 520, 528 (Mo.App.1997); *In the Matter of Union Electric Company*, 27 Mo.P.S.C. (N.S.) 183, 193 (1985) (*quoting Anaheim, Riverside, etc. v. Federal Energy Regulatory Commission*, 669 F.2d 779, (D.C. Cir. 1981)).
[196] *State ex rel. City of St. Joseph v. Public Service Commission*, 30 S.W.2d 8, 14 (Mo. banc 1930); In the Matter of Missouri-American Water Company's Tariff Sheets, *Report and Order*, Case No. WR-2000-281 (August 31, 2000).

true-up period, were reasonable and should be included in the calculation of rates for Lake Region.

Staff proposed that since these legal expenses are not a normal recurring cost, a five-year amortization with a tracker to prevent over-recovery is an appropriate mechanism to recover the expenses. The other parties agree that if these expenses are allowed, Staff's proposed amortization period and tracker should be applied. The Commission concludes that a five-year amortization with a tracker to prevent over-recovery is a reasonable mechanism to recover the expenses.

In making this decision as described above, the Commission has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the material was not dispositive of this decision.

Additionally, Lake Region provides safe and adequate service, and the Commission concludes, based upon its independent review of the whole record, that the rates approved as a result of this order support the provision of safe and adequate service. The revenue increase approved by the Commission is concluded to be no more than what is sufficient to keep Lake Region's utility plants in proper repair for effective public service and provide to Lake Region's investors an opportunity to earn a reasonable return upon funds invested.

THE COMMISSION ORDERS THAT:

1. Lake Region Water & Sewer Company's objections to evidence presented by Staff and Public Counsel regarding availability fees as described in the body of this report and order are overruled.

2. The water and sewer service tariff sheets submitted on July 16, 2013, by Lake Region Water & Sewer Company, assigned Tariff Nos. YW-2014-0024 and YS-2014-0023, are rejected. The specific sheets rejected are:

P.S.C. MO. No. 1 (Water)

Second Revised Sheet No. 4, Replacing First Sheet No. 4
Second Revised Sheet No. 5, Replacing First Sheet No. 5
First Revised Sheet No. 7-A, Replacing Original Sheet No. 7-A

P.S.C. MO. No. 2 (Sewer)

Third Revised Sheet No. 6, Replacing Second Revised Sheet No. 6
Third Revised Sheet No. 7, Replacing Second Revised Sheet No. 7
Second Revised Sheet No. 8, Replacing First Revised Sheet No. 8

3. Lake Region Water & Sewer Company is authorized to file tariff sheets sufficient to recover revenues approved in compliance with this order. Lake Region Water & Sewer Company shall file its compliance tariff sheets no later than May 7, 2014.

4. Lake Region Water & Sewer Company shall file the information required by Section 393.275.1, RSMo 2000, and Commission Rule 4 CSR 240-10.060 no later than May 7, 2014.

5. The Staff of the Missouri Public Service Commission shall file its recommendation concerning approval of Lake Region Water & Sewer Company's compliance tariff sheets no later than May 19, 2014.

6. Any other party wishing to respond or comment regarding Lake Region Water & Sewer Company's compliance tariff sheets shall file the response or comment no later than May 19, 2014.

7. All objections not ruled on are overruled and all pending motions not otherwise disposed of herein, or by separate order, are hereby denied.

8. This Report and Order shall become effective on May 30, 2014, except that Ordered Paragraphs 3, 4, 5 and 6 shall become effective upon issuance.

BY THE COMMISSION

Morris L. Woodruff
Secretary

R. Kenney, Chm., Stoll, W. Kenney, Hall, and Rupp, CC., concur and certify compliance with the provisions of Section 536.080, RSMo.

Dated at Jefferson City, Missouri, on this 30th day of April, 2014