

Exhibit No.:
Issue: Financing
Witness: Shana Atkinson
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case Nos.: WO-2014-0340
Date Testimony Prepared: October 3, 2014

**MISSOURI PUBLIC SERVICE COMMISSION
REGULATORY REVIEW DIVISION
UTILITY SERVICES DEPARTMENT
FINANCIAL ANALYSIS UNIT**

REBUTTAL TESTIMONY

OF

SHANA ATKINSON

**BRANDCO INVESTMENTS, LLC and
HILLCREST UTILITY OPERATING COMPANY, INC.**

CASE NO. WO-2014-0340

Jefferson City, Missouri
October 2014

**** Denotes Highly Confidential Information ****

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1 **REBUTTAL TESTIMONY**
2 **OF**
3 **SHANA ATKINSON**
4 **BRANDCO INVESTMENTS, LLC and**
5 **HILLCREST UTILITY OPERATING COMPANY, INC.**
6 **CASE NO. WO-2014-0340**

7 Q. Please state your name.

8 A. My name is Shana Atkinson.

9 Q. What is your present position with the Missouri Public Service Commission
10 (Commission)?

11 A. I am a Utility Regulatory Auditor III in the Financial Analysis Unit.

12 Q. What is your educational background?

13 A. In May 2007, I earned a Bachelor of Science in Accountancy and a Master of
14 Accountancy degree from the University of Missouri-Columbia. My accounting degree
15 required an understanding of financial concepts, including the cost of capital.

16 On June 21, 2010, I was awarded the Certified Rate of Return Analyst (CRRRA)
17 professional designation by the Society of Utility and Regulatory Financial Analysts
18 (SURFA). This designation is awarded based upon experience and successful completion of
19 a written examination, which I completed during my attendance at a SURFA conference in
20 April 2010.

21 Q. Have you filed testimony in other cases before this Commission?

22 A. Yes. Please see Schedule SA-1.

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1 Q. Have you made recommendations in any other cases before this Commission?

2 A. Yes. I have developed rate of return recommendations for numerous small
3 water and sewer rate cases and have made recommendations in finance cases, small water
4 and sewer certificate cases, and telephone certificate cases.

5 Q. What is the purpose of your rebuttal testimony?

6 A. The purpose of my rebuttal testimony is to respond to the direct testimony of
7 Josiah Cox on the financing being requested and his opposition to Staff's proposed
8 conditions of Staff's recommendation for this case. Mr. Cox sponsored testimony on behalf
9 of the Hillcrest Utility Operating Company, Inc. ("Hillcrest" or "Company").

10 Q. What is Mr. Cox's primary concern regarding Staff's proposed conditions?

11 A. Mr. Cox does not agree with the condition to only allow Hillcrest to
12 collateralize up to \$790,000 of its assets to issue secured debt and the condition to require
13 Hillcrest to make additional equity contributions and/or reduce the amount of debt if the
14 Company's debt service coverage ratio should fall below 1.50 times or the Debt/ Earnings
15 Before Interest, Taxes, Depreciation and Amortization (Debt/EBITDA) ratio exceeds
16 5.00 times.

17 Q. What is Staff's response?

18 A. Based on Hillcrest's representation that the debt investor, Fresh Start
19 Ventures, LLC ("Fresh Start"), is making a passive debt investment, Staff's main concern in
20 regard to Hillcrest's financing proposal for this acquisition is whether Hillcrest's projected
21 cash flows, which are heavily dependent on future ratemaking assumptions, would generate
22 sufficient cash flow to be able to meet its annual interest and principal payments on the

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1 20-year, ** ____ ** interest rate debt proposed in the Application.¹ Staff recommended
2 these conditions to mitigate its concern that Hillcrest's proposed financing arrangement
3 would result in a default on the obligation to Fresh Start, and therefore, a potential
4 elimination of the equity investors, which includes a ** ____ ** interest of Josiah Cox, the
5 primary individual that will control and manage the proposed investment.

6 The debt service coverage ratio is a good measure of a company's ability to service
7 its debt and the Debt/EBITDA ratio is a good measure of the amount of leverage the
8 company's cash flows may be able to support. If the debt service coverage ratio equals 1.00,
9 it would mean the company is generating just enough cash to pay its annual debt payment.
10 Based on Staff's estimate of potential rates after the planned construction, Hillcrest's debt
11 service coverage ratio would only be 1.18 times if they issued the requested \$1,000,000. The
12 financial covenants in the loan documents provided in response to Staff's Data Request (DR)
13 No. 0004 explain that Hillcrest shall not permit the ** _____
14 _____ ** is
15 the same as the ** _____ **
16 Hillcrest would be in violation of the ** _____ ** covenant even
17 without assuming any downside scenarios. Staff does not believe it is prudent to authorize
18 Fresh Start's collateralization of the utility properties, an unknown entity with unknown
19 intentions, if it appears Hillcrest may only be able to marginally meet its debt service
20 requirements under more conservative ratemaking assumptions. Fresh Start is not a party to
21 this case, but during the pendency of this case, Fresh Start has now been allowed a ** ____
22 _____ ** in Hillcrest as a result of further

¹ The rate indicated in the Application has been amended to this rate.



1 negotiations between Josiah Cox and principals with Fresh Start. Regardless, Staff still
2 believes it is reasonable to reduce the amount of debt allowed to target an estimated debt
3 service coverage ratio of at least 1.50, which is more typical of minimums required by
4 traditional debt investors. Staff estimates that the Company can borrow \$790,000 at
5 Hillcrest's proposed financing terms of an interest rate of ** ____ ** with a ** __ ** year
6 amortization for Hillcrest's debt service coverage ratio to equal at least 1.50 times.

7 The Debt/EBITDA ratio is used by credit rating agencies, such as Standard & Poor's
8 (S&P), to assess the probability of default. The higher a company's Debt/ EBITDA ratio, the
9 greater a company's financial risk is in regards to making its debt payments. S&P's financial
10 benchmarks list a Debt/EBITDA of greater than 5 times as a "Highly Leveraged" financial
11 risk in its matrix for its "Standard" volatility table. "Highly Leveraged" is the highest
12 financial risk category of the financial risk profiles in S&P's Business and Financial Risk
13 Profile Matrix. Based on Hillcrest's current proposed debt amount of \$1,000,000, its
14 Debt/EBITDA would be 5.68 times if Staff's more conservative rate case assumptions are
15 used. If Hillcrest issued \$790,000, its Debt/EBITDA would be approximately 4.49 times.

16 Q. Mr. Cox states in his direct testimony on page 14, lines 19-23, "Second,
17 Hillcrest cannot agree to proposed Condition 4q. This condition purports to require the
18 company to capitalize itself with equity contributions in certain circumstances. How a utility
19 chooses to capitalize itself is a matter within its own discretion and the Commission's
20 authority to regulate does not give it the right to dictate a specific result without some
21 evidence of abuse." What is Staff's response?

22 A. Staff's recommended condition states "Requires Hillcrest to maintain certain
23 minimum financial covenants. If the debt service coverage ratio should fall below 1.50 times

1 or the Debt/EBITDA ratio exceeds 5.00 times, Hillcrest must cure the violation of these
2 covenants by making additional equity contributions and/or reducing the amount of debt at
3 no cost to the ratepayer.” This condition mitigates Staff’s concern of Hillcrest going into
4 default and Fresh Start taking control of the utility assets. Staff does not know Fresh Start’s
5 intentions upon a default of the Hillcrest loan. Fresh Start is not a traditional lender regulated
6 by state or federal banking authorities. Fresh Start was formed in 2014 and was initially
7 capitalized with \$1.785 million by a group of 12 equity investors.² Fresh Start’s investors
8 all have some previous investment affiliation with two of the owners in Central States Water
9 Resources, Inc. (CSWR), Tom Manz and Ross Kersey. CSWR owns Hillcrest. Because of
10 the unique circumstances surrounding the proposed investment structure and affiliations
11 between the proposed debt investor, Fresh Start, and two of the equity investors of Hillcrest,
12 Staff has concerns about whether the proposed financing’s ** ____ ** interest rate would be
13 a fair and reasonable rate for purposes of setting Hillcrest’s allowed return.

14 Q. What does Staff mean by “unique circumstances surrounding the proposed
15 investment structure”?

16 A. The investment structure is not a traditional third-party debt relationship. On
17 paper, the investment structure is portrayed as a corporation with initially three, but now four
18 equity investors with a passive debt investor. However, considering the proposed large
19 monetary capital investment of Fresh Start, approximately 80% of total planned
20 capitalization, it appears that Fresh Start’s investment is more similar to the strategy
21 employed by a limited partner in a limited partnership. This became more apparent when
22 Hillcrest asked Fresh Start for a lower rate on the “debt” investment in return for some equity

² United States Securities and Exchange Commission Form D Notice of Exempt Offering of Securities, filed on February 17, 2014.

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1 consideration. Hillcrest and Fresh Start negotiated a ** _____ ** reduction to the
2 interest rate in return for Fresh Start receiving an equity participation of ** ____ **, which is
3 held by the entity, ** _____ **

4 Q. Does Mr. Cox explain why a private equity investor would contribute both
5 debt and equity capital to the same investment under a limited partnership agreement?

6 A. Yes. In response to Staff's DR No. 0037, Mr. Cox states ** _____
7 _____
8 _____
9 _____
10 _____

11 _____ ** This illustrates that the ** ____ ** indicated return
12 is more similar to a negotiated rate often performed by a limited partner attempting to
13 subordinate the partner that has not contributed the monetary capital, i.e. the general partner.
14 In such situations, the partner providing this capital is simply ensuring that they receive any
15 cash flow before the other partner. Often, in such situations, the partner that subordinated the
16 other partner does not expect to receive the payments on the contract on the dates they are
17 due, but the contractual payments will accrue and will be required to be paid before the
18 subordinated partner can receive a return on the investment.

19 Q. Why didn't Hillcrest structure the proposed investment as a limited
20 partnership arrangement?

21 A. It is Staff's understanding that Josiah Cox believed the Missouri Public
22 Service Commission would not allow this structure. However, this is not the case because
23 certain utilities in Missouri have been owned under this type of structure; with Southern

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1 Missouri Natural Gas Company being the one with which the Financial Analysis Unit is most
2 familiar. In order to seek an understanding as to why Mr. Cox came to this conclusion, Staff
3 issued DR No. 0034 to receive an explanation. Mr. Cox stated ** _____

4 _____

5 _____

6 _____

7 _____

8 _____

9 _____

10 _____

11 _____

12 _____ **

13 Q. Does the above answer indicate that the Commission would not allow such
14 a structure?

15 A. No. It simply indicates that Staff communicated to prospective capital
16 investor that if the investor issued debt to fund its equity investment, Staff would investigate
17 and potentially recommend that the investor's allowed rate of return be set based on the cost
18 of debt supporting the equity investment.

19 Q. Do you know who on Staff met with ** _____ **?

20 A. I believe it was David Murray, Jim Busch and Mark Oligschlaeger.

21 Q. Who on Staff would have likely have addressed ** _____ **
22 question about a potential rate of return?

23 A. David Murray.



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1 Q. If Staff had only discussed potential ratemaking considerations in a limited
2 partnership arrangement with the potential investor, does this mean Staff indicated the
3 Commission would not allow this investment structure?

4 A. No.

5 Q. What appears to have driven Mr. Cox's decision to structure the investment as
6 proposed in the Application?

7 A. Ratemaking considerations. However, he and Fresh Start are still representing
8 to Staff that if Hillcrest defaults on the loan, then Fresh Start may foreclose on the assets and
9 eliminate Hillcrest's equity interest. Consequently, considering such representations, Staff
10 believes it is important to ensure the equity investors are committed to the investment by
11 imposing Staff's conditions.

12 Q. Does this conclude your rebuttal testimony?

13 A. Yes, it does.

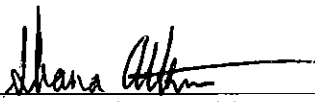
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of)
Brandco Investments, LLC and Hillcrest) Case No. WO-2014-0340
Utility Operating Company, Inc., for Hillcrest)
to Acquire Certain Water and Sewer Assets of)
Brandco and, In Connection Therewith, Issue)
Indebtedness and Encumber Assets)

AFFIDAVIT OF SHANA ATKINSON

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

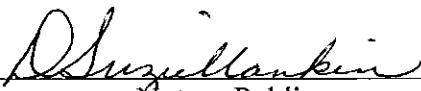
Shana Atkinson, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 8 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.



Shana Atkinson

Subscribed and sworn to before me this 3rd day of October, 2014.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070



Notary Public

SUMMARY OF CASE PARTICIPATION

SHANA ATKINSON

Date Filed	Issue	Case Number	Exhibit	Case Name
09/12/2014	Return on Equity	SR-2014-0166	Rebuttal	Hickory Hills Water & Sewer Company
09/12/2014	Return on Equity	WR-2014-0167	Rebuttal	Hickory Hills Water & Sewer Company
5/1/2014	Rate of Return Capital Structure	HR-2014-0066	Cost of Service Report	Veolia Energy Kansas City, Inc.
1/31/2014	Rate of Return Capital Structure	WR-2013-0461	Surrebuttal	Lake Region Water & Sewer Company
1/31/2014	Rate of Return Capital Structure	SR-2013-0459	Surrebuttal	Lake Region Water & Sewer Company
11/15/2013	Rate of Return Capital Structure	WR-2013-0461	Cost of Service Report	Lake Region Water & Sewer Company
11/15/2013	Rate of Return Capital Structure	SR-2013-0459	Cost of Service Report	Lake Region Water & Sewer Company
2/4/2013	Rate of Return Capital Structure	ER-2012-0345	Surrebuttal	Empire District Electric Company
1/16/2013	Rate of Return Capital Structure	ER-2012-0345	Rebuttal	Empire District Electric Company
11/30/2012	Rate of Return Capital Structure	ER-2012-0345	Cost of Service Report	Empire District Electric Company
8/20/2012	Rate of Return Capital Structure	ER-2012-0345	Interim Rebuttal	Empire District Electric Company

SUMMARY OF CASE PARTICIPATION

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Date Filed	Issue	Case Number	Exhibit	Case Name
5/6/2011	Rate of Return Capital Structure	ER-2011-0004	True-Up Direct	Empire District Electric Company
4/28/2011	Rate of Return Capital Structure	ER-2011-0004	Surrebuttal	Empire District Electric Company
4/18/2011	Rate of Return Capital Structure	ER-2011-0004	Rebuttal	Empire District Electric Company
2/23/2011	Rate of Return Capital Structure	ER-2011-0004	Cost of Service Report	Empire District Electric Company
4/23/2010	Rate of Return Capital Structure	ER-2010-0130	Surrebuttal	Empire District Electric Company
4/02/2010	Rate of Return Capital Structure	ER-2010-0130	Rebuttal	Empire District Electric Company
2/26/2010	Rate of Return Capital Structure	ER-2010-0130	Cost of Service Report	Empire District Electric Company
1/13/2010	Rate of Return Capital Structure	WR-2010-0111	Cost of Service Report	Lake Region Water & Sewer Company
1/13/2010	Rate of Return Capital Structure	SR-2010-0110	Cost of Service Report	Lake Region Water & Sewer Company
10/20/2009	Rate of Return Capital Structure	GR-2009-0434	Cost of Service Report	Empire District Gas Company