BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

CORRECTED APPLICATION FOR REHEARING

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

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

THE FACTS

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

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

At hearing, under Public Counsel's questioning. Mr. Cox revealed the structure of First Round-Central States Water Resources. The Glarners are the "ultimate owners" and Mr. Cox has a 14-percent ownership interest. (Tr. Vol. 2, 50:17 – 51:12). Mr. Cox and his partners "negotiated" a

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

14% cost of debt. That the owners are the investors and are able to claim a 14% cost of debt is the definition of self dealing. By statute, Hillcrest has the burden of proof that the cost of debt is just and reasonable. Section 393.130 RSMo.

Staff testified that the transactions are complex.

At hearing, Staff witness Shana Griffin testified: "[c]omplexity of the investment structure", and inquired "is the way Hillcrest is set up and the way that money flows, is that a complex structure in your opinion?" Griffin responded simply, "Yes." Next, Public Counsel asked, "Is it overly complex?" Griffin explained: "It is very hard to understand what has happened originally with the investment structure that was presented to staff in the certificate and financing case up to now." (Tr. Vol. 2, 164:23 – 165:10).

Moreover, in response to the question, "[a]nd is that because as you state in Line 13 that there is a lack of transparency and access to information?" Griffin agreed, saying "Yes." (Tr. Vol. 2, 165: 11–14.).

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

THE LAW

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

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

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

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

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

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

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

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

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

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

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

Even though it has no burden of proof, Staff diligently performed its analysis pointing to the range of *.88% to 10.13% as a reasonable cost of debt. Staff based its recommendation on junk bond debt yields from published indices. Staff states this level of cost of debt "would satisfy a hypothetical third-party debt investor's market requirements. (Order at p. 23, ¶ 11, *citing* Staff Ex. 4, Griffin Direct, p. 4-7; Staff Ex. 6, Griffin Rebuttal, p. 5).

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

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

Mr. Cox reportedly sought financing from "over fifty specialized infrastructure institutional investors, private equity investors, investment bankers and commercial banks on behalf of Hillcrest and its parent company." (Order at p. 22, ¶ 6, *citing* Hillcrest Ex. 1, Cox Direct, p. 24; Transcript, Vol. 2, p. 51.).

This lack of interest surely caused Mr. Cox some concern yet he still decided to purchase this distressed company.

The Commission should reconsider the corporate allocation factor.

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

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

In its Order, the Commission found "[t]he evidence shows that after diligent efforts to obtain financing from a variety of potential lenders, the only financing available to Hillcrest at that time was the transaction with Fresh Start. Penalizing Hillcrest now for that decision would be unfair and may discourage other companies from acquiring and improving troubled water and sewer utilities in the future, which would be contrary to good public policy." (Order at p. 28). Rewarding Mr. Cox's lack of credibility and unusual business practices are also contrary to good public policy.

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

CONCLUSION

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

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

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

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Certificate of Service

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