

**BEFORE THE PUBLIC SERVICE COMMISSION OF
THE STATE OF MISSOURI**

In the Matter of the Request for Increase in)	
Annual Sewer Operating Revenues MO PSC)	<u>File No. SR-2024-0344</u>
Small Utility Rate Case)	

NOTICE OF SUBSTITUTE ATTACHMENT

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), by and through counsel, states as follows:

1. On November 25, 2024, Staff and Holtgrewe Farms Sewer Company, LLC filed a *Non-Unanimous Agreement Regarding Disposition of Small Utility Company Revenue Increase Request*.
2. On December 3, 2024, it was brought to Staff's attention that Attachment B to the *Agreement* was related to Holtgrewe Farms Water Company, LLC.
3. Filed with this *Notice* is a substitute Attachment B for Holtgrewe Farms Sewer Company, LLC.

WHEREFORE, Staff submits this *Notice of Substitute Attachment* for the Commission's information and consideration.

Respectfully submitted,

/s/ Casi Aslin

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was delivered to the parties and/or their counsel of record by U.S. Postal Service postage prepaid, or by hand, or served electronically, on this 3rd day of December, 2024.

/s/ Casi Aslin

AUDIT RECOMMENDATION MEMORANDUM

FROM: Keri Roth
Water, Sewer, & Steam Department
Randall Jennings
Financial Analysis Department

TO: David Spratt
Water, Sewer, & Steam Department, Case Manager
Paul Graham
Mark Johnson
Staff Counsel's Office

SUBJECT: Water, Sewer, & Steam Department's Findings and Recommended Cost of Service
Holtgrewe Farms Sewer Company, LLC
Case No. SR-2024-0344

DATE: September 25, 2024

On May 24, 2024, Holtgrewe Farms Sewer Company, LLC ("Holtgrewe Sewer" or "Company") filed a rate request letter with the Missouri Public Service Commission ("PSC" or "Commission"). In that letter, which initiated this rate case, Holtgrewe Sewer requested an increase of \$10,000 in its annual sewer operating revenues. Staff performed an initial audit of Holtgrewe Sewer's sewer operations to determine whether an increase is appropriate and, if so, the amount thereof that would be reasonable.

Based upon Staff's examination of Holtgrewe Sewer's records and discussions with company personnel, Staff's recommended total revenue requirement calculation for Holtgrewe Sewer's sewer operations through December 31, 2023 and updated through March 31, 2024, using a return on equity ("ROE") of 9.94%, is \$33,619. The total revenue requirement in this case represents the Gross Revenue Requirement of \$12,424 calculated by Staff plus the current Total Operating Revenues of \$21,195. Attached to this Memorandum is Staff's Accounting Schedules and relevant workpapers related to its review and audit of Holtgrewe Sewer's financial operations.

Test Year and Update Period

Staff used a test year consisting of the twelve months ending December 31, 2023, updated through March 31, 2024.

Rate Base

Staff reviewed Holtgrewe Sewer's annual reports, previous 2010 Certificate of Convenience and Necessity ("CCN") case, and held discussions with Company personnel for information regarding Construction Work in Progress ("CWIP"), Contributions in Aid of Construction ("CIAC"), and customer deposits respectively. Staff determined that Holtgrewe does

have CIAC for its sewer operations and this has been reflected in Staff's rate base calculation. Staff's recommended rate base as of March 31, 2024, is \$76,705.

Plant-In-Service Balances

To account for plant investment, Staff utilized information and numbers calculated from Case No. SA-2010-0282 and made adjustments for additional plant investments and retirements. Staff obtained information regarding plant additions from invoices provided by Holtgrewe Sewer posted in the check register. Staff's recommended net plant balance less accumulated reserve, as of March 31, 2024, is \$198,246.

Depreciation Rates

The depreciation rates used in this rate case are included as Attachment A to this memorandum. Staff member Malachi Bowman of the Commission's Engineering Analysis Department provided the depreciation rates.

Revenues

The number of customers indicated in Holtgrewe Sewer's rate request letter was used to annualize revenues. The number of customers was multiplied by the current monthly tariff rate, and then multiplied by twelve to derive the annualized customer charge revenue. Holtgrewe Sewer does not have any miscellaneous revenues. Staff's analysis of revenues for Holtgrewe Sewer produced an annualized level of \$21,195 for sewer sales.

Testing Expense

Holtgrewe Sewer utilizes ESA, Inc. to perform test samples for the sewer operations. Based on information provided, Staff determined utilizing the test year amount was the best way to capture an accurate level of expense going forward. Staff has included \$597 for sewer testing expense.

Mowing Expense

Based on discussion with Company personnel, Staff has included an annualized level of expense of \$1,500 for mowing expense.

Maintenance Expense

Staff reviewed costs from 2020 through March 31, 2024. During this period, there did not appear to be much maintenance expense recorded for the sewer system. However, the Company does have the septic tank pumped once per year. Staff has included an annual expense of \$1,472 for pumping and maintenance expense.

Operating and Assessment Fees

Staff made an adjustment to include PSC Assessment fees based on the fiscal year 2025 assessment. The annualized level of expense for the PSC Assessment is \$157.

Staff annualized DNR permit fees based on the information provided by Holtgrewe Sewer. The annualized level of expense for DNR permit fees is \$1,000.

Rate of Return and Capital Structure

Staff's Financial Analysis Department provided the Audit Staff with a rate of return ("ROR") recommendation. To recommend the allowed ROR, the Staff of the Financial Analysis Department used its "Small Utility Return on Equity (ROE)/Rate of Return (ROR) Methodology" ("ROR Methodology"). Staff's ROR Methodology is based on the S&P Credit Ratings guide¹ and the Bond Yield Plus Risk Premium method. The S&P Credit Ratings guide provides parameters for estimating credit ratings. Credit ratings are in turn used to estimate debt cost. The Bond Yield Plus Risk Premium method simply adds a premium, known as equity risk premium ("ERP"), to the estimated debt cost to come up with a return on equity ("ROE"). ROE is combined with debt cost to arrive at an estimated ROR.

To estimate credit ratings using the S&P Credit Ratings guide, Staff examined the financial risk profile ("FRP") and business risk profile ("BRP") of Holtgrewe Sewer. Usually, to examine the FRP and BRP of a small utility, Staff would analyze financial statements and ratios. In the case of Holtgrewe Sewer, there are limited financial statements available and the credibility of those financial statements is in question. The Company has filed Annual Reports with the Commission for years 2021, 2022 and 2023. The Company's 2023 balance sheet shows a large amount of negative Retained Earnings which can be an indicator of bankruptcy, since it implies a long-term series of losses.² This contradicts Profit and Loss statements filed with the Commission that indicate net operating incomes for years 2021 through 2023. During Staff's onsite visit, the Company was unable to provide any details and said it is the Company's understanding that Retained Earnings is simply used to make Assets equal Liabilities plus Capital on the balance sheet. As a result, information provided by the Company in its Annual Reports cannot be considered completely credible or accurate.

Background information on utilities' BRP is important in determining the Company's BRP. According to a November 27, 2007 S&P Credit Ratings publication, regulated utilities and holding companies that are utility-focused virtually always fall in the upper range ("Excellent" or "Strong") of the BRP.³ Staff has not seen any information or evidence that shows the Company's BRP is significantly different from other sewer utilities. The main difference between Holtgrewe Sewer and sewer utilities rated by S&P is size: HFSC serves only 45 (forty-five) customers. In

¹ Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009.

² Negative retained earnings definition; <https://www.accountingtools.com/articles/what-are-negative-retained-earnings.html>

³ U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix, November 30, 2007.

Staff's reasonable judgement, a BRP of "Satisfactory", a notch lower than the "Strong" assigned to regulated utilities by S&P Credit Ratings, for Holtgrewe Sewer is appropriate.

For FRP, the Company submitted annual reports listing net incomes for each year from 2021 through 2023. Net incomes would normally indicate that the Company is operating in a sustainable manner, and considered by itself would indicate a minimal financial risk. The Company's annual reports filed with the Commission revealed its long-term debt was reduced by approximately 50% in 2022. As described earlier, Staff has also seen a large amount of negative Retained Earnings and has experienced difficulty in obtaining information from the Company. In addition to these observations, The Company also stated during Staff's onsite visit that all company financing comes in the form of personal loans from the owner to Holtgrewe Sewer and that the debt has either been forgiven or not reported rather than being paid back since 'the company does not make enough profit to pay off the debt.' The combination of these factors leads Staff, in its reasonable judgment, to believe an FRP of "Intermediate" is appropriate.

With a BRP and FRP of "Satisfactory" and "Intermediate" for Holtgrewe Sewer, respectively, the S&P Credit Ratings guide matrix indicates a credit rating of 'BBB/Baa'. A credit rating of 'BBB/Baa' for public utilities bonds has an average interest rate of 5.94% for the most recent three-month average.⁴ Because of high inflation, the Federal Open Market Committee ("FOMC") has currently set the target range for the federal funds rate at 5.25% to 5.50%. There is a possibility of possible future interest rate changes. Staff will monitor market conditions and update as needed. Adding a 4% ERP, as prescribed by the Bond Yield Plus Risk Premium method, to the 5.94% estimated debt cost results in a 9.94% ROE.

Regulated companies are financed through both debt (loans or bonds) and equity (shareholder investment, either through publicly traded stock or through private placement). Staff typically uses a company's actual, a company's targeted, or a hypothetical capital structure. Because Holtgrewe Sewer has been unable to provide what Staff believes to be accurate financial statements, as discussed above, Staff is unable to use the Company's actual capital structure. Staff submitted a Data Request asking for the Company's targeted capital structure but HFSC did not respond.⁵ Therefore, Staff is recommending using a hypothetical capital structure of 50.00% debt and 50.00% common equity for the Company's ratemaking capital structure. According to annual reports filed with the Commission, the Company's debt is financed at a fixed rate of 3.00%. Staff's recommended ROE of 9.94% for Holtgrewe Sewer and an embedded cost of debt of 3.00% applied to a capital structure of 50.00% debt and 50.00% common equity, results in an allowed ROR of 6.47%.

Payroll

⁴ April, May and June 2024 reflect interest rates of 6.01%, 5.97% and 5.84% respectively. July 2024 Mergent Bond Record, page 25.

⁵ Staff Data Request No. 0022.

Through discussions with Company personnel, Staff has included payroll expense for duties related to billing and bookkeeping, operations and maintenance, meter reading, and management. Staff utilized hourly wages from year 2023 as shown in MERIC. Staff has included a total annual expense level of \$9,576.

General Liability Insurance

Staff utilized the most current policy amount to annualize insurance expense. The annualized level of general liability insurance expense is \$1,105.

Rate Case Expense

The only rate case expense was internal labor costs; therefore, Staff did not include any rate case expense at this time.

Utilities Expense

Typically, Staff would utilize usage to calculate utility expense. However, utility expense fluctuated significantly from each total calendar year 2020 through 2023. Staff made the decision to utilize a two-year average of utility expense for Holtgrewe Sewer's cost of service, which is \$1,431.

Accounting Expense

Holtgrewe Sewer utilizes an outside accounting firm for annual tax returns. Based on information provided, the annual level of expense has been steady in recent years. Staff utilized the most recent invoice as an appropriate level of expense to be included for accounting expense, which is \$175.

Office Supplies and Postage

Based on information provided by the Company, office supplies and postage expense has fluctuated yearly from 2020 through 2023. Staff determined that utilizing a four-year average would be the best representation of annual expenditures for office supplies and postage. Staff has included \$205 in the cost of service.

STAFF'S RECOMMENDATIONS

Staff recommends that the Commission issue an order that:

- Requires Holtgrewe Sewer to implement the Uniform Systems of Accounts for Class D Sewer Utilities 1976 ("USOA") as prescribed by 20 CSR 4240-61.020, separately from its water utility company;
- Requires Holtgrewe Sewer to maintain documentation of sewer related revenues and costs, separately from its water utility company;

- Requires Holtgrewe Sewer to keep records identifiable for its sewer system, separately from its water utility company, including those for customer account records and capital costs; and,
- Authorizes Holtgrewe Sewer to utilize depreciation rates that are shown in Attachment B.