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Capital Structure, Cost of Capital, Rate Case
Expense
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Rebuttal Testimony

of

Josiah Cox

On Behalf of

Hillcrest Utility Operating Company, Inc.

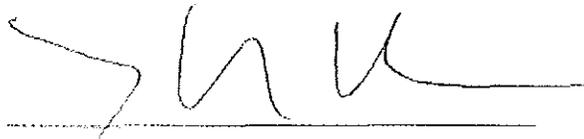
May 11, 2016

Hillcrest Exhibit No. 2
Date 5/19/16 Reporter JMB
File No. WR-2016-0064

AFFIDAVIT

STATE OF MISSOURI)
)
COUNTY OF St. Louis) ss

I, Josiah Cox, state that I am the President of Central Rivers Wastewater Utility, Inc. and Hillcrest Utility Operating Company, Inc., that the answers to the questions posed in the attached Rebuttal Testimony are true to the best of my knowledge, information and belief.



Subscribed and sworn to before me this 11th day of May, 2016.


Notary Public

My Commission Expires: 1/31/2017

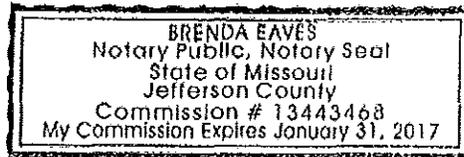


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**REBUTTAL TESTIMONY OF
JOSIAH COX
HILLCREST UTILITY OPERATING COMPANY, INC.**

WITNESS INTRODUCTION

1

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Josiah Cox. My business address is 500 Northwest Plaza Drive
4 Suite 500. St. Ann MO, 63074

5

6 **Q. ARE YOU THE SAME JOSIAH COX THAT PREVIOUSLY PROVIDED DIRECT**
7 **TESTIMONY IN THIS CASE ON BEHALF OF HILLCREST UTILITY**
8 **OPERATING COMPANY, INC. (HILLCREST OR COMPANY)?**

9 A. Yes, I am.

10

PURPOSE

11

12 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

13 A. I will respond to certain aspects of the direct testimony of the Staff of the Public
14 Service Commission (Staff) and the Office of the Public Counsel (OPC) as to the
15 following issues: (1) Rate Design; (2) Property Taxes; (3) Payroll; (4) Capital
16 Structure; (5) Cost of Capital (equity and debt); and, (6) Rate Case Expense.

17

18

RATE DESIGN

1
2 **Q. STAFF AND OPC BOTH PROPOSE THAT THE HILLCREST RATES BE**
3 **ADJUSTED FROM ONE CLASS, TO MORE THAN MORE CLASS OF**
4 **CUSTOMERS. WHAT IS HILLCREST'S POSITION AS TO THESE**
5 **PROPOSALS?**

6 A. Hillcrest has no objection to the proposals to move to more than one class of
7 customers.

8
9 **Q. DO YOU HAVE A CONCERN IN REGARD TO THE AVERAGE USAGE THAT**
10 **HAS BEEN USED FOR THE RATE DESIGN CALCULATION?**

11 A. Yes. Staff uses 5,300 gallons per month per customer as a base line to
12 determine to the "per 1,000 gallon" charge necessary to recover the Staff's
13 revenue requirement for water. Hillcrest has over one year of data that shows
14 customers use an average of 3,744 gallons per month per customer. On a
15 monthly average basis, the lowest per customer usage is 2,809 gallons and the
16 highest is 4,810 gallons. We believe Staff needs to either raise the base rate
17 charge per customer or change the volumetric charge in order to provide a
18 reasonable opportunity to create the proper revenue requirement. Attached as
19 Rebuttal Schedule JC-1 is the Hillcrest Monthly Usage to which I have referred.

20
21 **Q. STAFF WITNESS ROBERTSON AND OPC WITNESS RUSSO BOTH**
22 **PROVIDE A "PHASE-IN" PROPOSAL FOR THE COMMISSION'S**

1 **CONSIDERATION. HOW DO YOU UNDERSTAND THAT THOSE**
2 **PROPOSALS WOULD WORK?**

3 A. Generally, they both would set rates based on some amount less than the full
4 annual revenue requirement. The amounts associated with the unrecovered
5 revenue requirement would then be "carried over" and used to determine rates in
6 the next rate case.

7
8 **Q. WHY IS STAFF PRESENTING THIS PHASE-IN OPTION TO THE**
9 **COMMISSION?**

10 A. Staff witness Robertson states that the "reason for considering a phase-in is to
11 alleviate the amount of 'rate shock' on the customer as a result of implementing
12 the entire rate increase all at once." (Robertson Dir., p. 8)

13
14 **Q. IS THAT THE ONLY RATE DESIGN STAFF PROVIDES?**

15 A. No. Staff also provides a rate design that would recover the revenue
16 requirement in current rates.

17
18 **Q. WHAT IS THE STATED REASON THAT OPC RECOMMENDS A PHASE-IN?**

19 A. OPC Witness Russo suggests that a phase-in may be appropriate to "mitigate"
20 "rate shock." (Russo Dir., p. 14)

21
22 **Q. HOW DOES MR. RUSSO DEFINE "RATE SHOCK"?**

1 A. He says that rate shock, in his opinion, is "any proposed rate over 100% greater
2 than the existing rate." (Russo Dir., p. 14)

3

4 **Q. DOES A CERTAIN PERCENT INCREASE ALWAYS HAVE THE SAME**
5 **IMPACT ON RATES?**

6 A. No. A percent increase is always dependent on the current rate.

7

8 **Q. WHAT ARE THE CURRENT RATES FOR HILLCREST?**

9 A. For Sewer Hillcrest currently charges \$14.63 per month for single family
10 residential homes and \$11.70 per month for the twenty apartments inside the
11 Hillcrest subdivision.

12 For Water Hillcrest currently charges \$3.58 as a service charge and \$1.84 per
13 1,000 gallons. The average resident in Hillcrest currently pays \$20.33 per month
14 for water service.

15

16 **Q. HAVE THE CUSTOMERS OF HILLCREST EXPERIENCED A RATE**
17 **INCREASE RECENTLY?**

18 A. No. We believe that the rates have not changed since the systems were
19 established in 1989.

20

21 **Q. HAS THAT BEEN A BENEFIT TO THE CUSTOMERS?**

1 A. In one respect, yes. However, as stated in my Direct Testimony, the water and
2 sewer systems were also in a complete state of disrepair when Hillcrest acquired
3 the utility assets of Brandco Investments, LLC.
4

5 **Q. HAS HILLCREST INVESTED SUBSTANTIAL AMOUNTS TO REMEDY THIS**
6 **SITUATION?**

7 A. Yes. Hillcrest began construction on the drinking water and wastewater
8 improvements approximately 30 days after it acquired the water and wastewater
9 systems. The drinking water and wastewater improvements cost approximately
10 \$1,205,000, and were completed in the fall of 2015. Attached as Rebuttal
11 Schedule JC-2 is the letter Hillcrest received from the Department of Natural
12 Resources indicating that Hillcrest has successfully completed the requirements
13 set for the in the Administrative Order on Consent.
14

15 **Q. IS IT A SURPRISE THAT A HIGH PERCENTAGE INCREASE IS THE RESULT**
16 **OF THE LOW CURRENT RATE AND SUBSTANTIAL NEED FOR**
17 **IMPROVEMENT?**

18 A. No. In fact, in its acquisition application to this Commission in Case No. WO-
19 2014-0340, Hillcrest estimated that the required improvements would result in an
20 increase of \$49/month to the Hillcrest water rates and an increase of \$71/ month
21 for the sewer rates. That estimate would result in a monthly rate of
22 approximately \$62.33/month for water and \$85.63/month for sewer. These
23 estimates were done well before Hillcrest owned the systems or started

1 operations or construction, so they were far from exact. However, they did
2 provide a decent indication of the type of increase that would be necessary to get
3 the systems in compliance and provide service.
4

5 **Q. OPC WITNESS RUSSO STATES THAT HE HAS COMPARED THE**
6 **PROPOSED WATER AND SEWER RATES TO OTHER REGULATED WATER**
7 **AND SEWER UTILITIES IN MISSOURI. (RUSSO DIR., P. 13) HAVE YOU**
8 **COMPARED THE PROPOSED RATES WITH RATES OF OTHER WATER**
9 **AND SEWER PROVIDERS?**

10 A. Yes.
11

12 **Q. WHAT DID YOU FIND?**

13 A. Hillcrest is similar to other utility service providers of the same size in the region
14 and across the state.

15 For example, approximately two miles west of the Hillcrest subdivision, the City
16 of Gordonville provides sewer service to a community that is similar in size to the
17 Hillcrest subdivision. Gordonville's sewer rate is \$59 per month for the first 1,000
18 gallons, plus \$10 per 1,000 gallons of additional use. For perspective,
19 Gordonville's rate applied to Staff's average usage for Hillcrest customers, would
20 equate to an average bill of \$83 per month for sewer service. I understand that
21 Gordonville spent \$2.8 Million dollars on improvements to its wastewater system
22 in the 2010 timeframe. Approximately \$1.3 Million of the Gordonville treatment
23 plant upgrade cost came in the form of a grant. The remaining \$1.5 million

1 dollars was lent to the City of Gordonville through the state of Missouri's
2 subsidized revolving fund direct loan program. See
3 [http://www.waterworld.com/articles/2009/05/city-of-gordonville-mo-gets-12m-](http://www.waterworld.com/articles/2009/05/city-of-gordonville-mo-gets-12m-grant-15m-loan-for-wastewater-system-improvements.html)
4 [grant-15m-loan-for-wastewater-system-improvements.html](http://www.waterworld.com/articles/2009/05/city-of-gordonville-mo-gets-12m-grant-15m-loan-for-wastewater-system-improvements.html).

5 This is an example where even with grant and financing opportunities not
6 available to investor-owned utilities, a small system must charge similar rates as
7 Hillcrest due to the amount of capital improvements required to meet MDNR
8 regulatory compliance, the associated raised operational/professional
9 management needed to run the new improvements, and the challenge of
10 spreading those costs across a small customer base.

11
12 **Q. DO YOU AGREE WITH OPC WITNESS RUSSO'S BASIS OF RATE**
13 **COMPARISON?**

14 A. I agree with OPC witness Russo as to how low the existing Hillcrest Tariffs are,
15 but I do not agree with comparing Hillcrest's proposed rates to all other regulated
16 utilities in the state. Mr. Russo's comparison does not properly account for the
17 reality that Hillcrest is a small utility. Hillcrest estimates there are 52 truly small
18 regulated sewer utilities in the state (Hillcrest defines small sewer companies as
19 sewer companies servicing under 8,000 customers not owned by entities that are
20 publically traded). Seven, or 13.5%, of these small regulated utilities are in state-
21 appointed receivership. Hillcrest estimates that 33 of the remaining 45 small
22 regulated utilities may currently be, or are about to be out of, federal and state
23 regulatory pollution or dispense permit compliance based on review of MDNR

1 records. Comparing Hillcrest's proposed rate, that supports safe, clean, reliable,
2 and environmentally compliant water and drinking water service over a small
3 customer base with a data set that is 77% failing does not paint an accurate
4 picture.

5
6 **Q. DO YOU ACKNOWLEDGE THAT THIS IS A DIFFICULT SITUATION FOR THE
7 HILLCREST CUSTOMERS?**

8 A. Absolutely, I do. However, in order to obtain financing to make improvements on
9 troubled small water and sewer systems, the utilities have to be able to show an
10 ability to make the payments required by such financing arrangements. That is
11 not possible with a phase-in.

12
13 **Q. OPC WITNESS RUSSO FURTHER STATES AS FOLLOWS:
14 "A BENEFIT TO THE COMPANY IS THEY ARE ALLOWED THE
15 OPPORTUNITY TO RECOVER THEIR FULL COST OF SERVICE AT THE END
16 OF THE RATE PHASE-IN PERIOD AND THE COMPANY IS ALLOWED TO
17 RECOVER CARRYING COSTS ON THE PORTION OF THE RATE INCREASE
18 THAT IS DELAYED FROM TAKING EFFECT ON DAY ONE OF ANY
19 APPROVED RATE INCREASE." (RUSSO DIR., P. 14)**

20 **DO YOU AGREE WITH THIS STATEMENT?**

21 A. Not as to Hillcrest. I can understand that in certain situations, a large corporation
22 that focuses on "earnings" might be able to withstand booking these unrecovered
23 revenues as a regulatory asset for future recovery. Hillcrest, unfortunately, is not

1 in that situation. Hillcrest needs cash to pay its bills. That cash will not be
2 provided in a timely manner by a regulatory asset on the books.

3
4 **Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE STAFF PHASE-IN**
5 **ALTERNATIVE.**

6 A. Staff witness Robertson discussed an alternative that would call for an initial rate
7 followed by a phase-in rate that would only go into effect after an entirely new
8 rate case that Hillcrest would be asked to file in a year. Under this approach, the
9 rates for the initial "phase-in year" would not include "non-cash items" and then a
10 new rate where carried costs would be amortized over a five-year period
11 (Robertson Dir., p.18). The total rate requirement proposed by staff for this
12 "phase in year" would be \$132,699 for water and \$157,253 for sewer.

13
14 **Q. HAVE YOU HAD A CHANCE TO COMPARE THE HILLCREST'S COSTS WITH**
15 **THE REVENUES THAT IT WOULD PURPORT TO RECEIVE AS A RESULT**
16 **OF THE STAFF PHASE-IN ALTERNATIVE?**

17 A. Yes. Between the agreed upon partial stipulation operational costs and
18 Hillcrest's actual debt service payments this "phase-in year" would cause
19 Hillcrest to default in the first year of operations. The "phase in year" does not
20 include any money for corporate management of Hillcrest, taxes, earnings on
21 improvements that are in service and used and useful, or depreciation expense
22 on improvements that are in service and used and useful.

23

1 **Q. WHAT WOULD BE THE IMPACT OF THIS APPROACH FOR A SMALL**
2 **UTILITY?**

3 A. In general, this type of approach can be very damaging to a small utility. Small
4 utilities are cash businesses that have real expenses like debt payments, tax
5 preparation fees, property taxes, and actual management costs that are required
6 to operate. Hillcrest believes a lack of professional management and a lack of
7 access to capital are major contributors to difficulties being experienced in many
8 of Missouri's small water and sewer systems.

9

10 **Q. DOES THE OPC PHASE-IN CAUSE THE SAME DIFFICULTY FOR**
11 **HILLCREST?**

12 A. Yes. The OPC has proposed an even longer phase-in period, which is even
13 more unworkable than the Staff's proposal. The first year of operations costs
14 proposed by OPC will not cover basic operational expenses of the water and
15 sewer systems.

16

17 **Q. COULD THOSE REVENUE REQUIREMENTS CREATE AN EVEN GREATER**
18 **PROBLEM FOR HILLCREST?**

19 A. Yes. A good portion of those revenues are dependent upon customer usage.
20 Any drop in customer usage will further exasperate this deficiency.

21

22 **Q. IS THERE ALSO A DOWNSIDE FOR CUSTOMERS ASSOCIATED WITH A**
23 **PHASE-IN?**

1 A. Yes. The carrying costs associated with the booking of those deferred revenues
2 means that, in the end, the customers will pay more out of their pockets, than
3 they would in the absence of a phase-in, all else being equal.
4

5 **Q. OPC WITNESS RUSSO FURTHER DESCRIBES A “PHASE IN” AS “AN**
6 **ESTABLISHED MECHANISM.” DOES HILLCREST AGREE WITH THAT**
7 **DESCRIPTION?**

8 A. No. Counsel for Hillcrest will address this matter from a legal and historic
9 perspective in the Company’s brief in this case.
10

11 **Q. IS HILLCREST THE ONLY UTILITY FACING THE POTENTIAL OF LARGE**
12 **RATE INCREASES IN MISSOURI?**

13 A. No. As I mentioned in my Direct Testimony, it is Hillcrest’s belief that 40 small
14 regulated utilities in Missouri currently face the same critical situation with large
15 safety, environmental, and/or service reliability issues pending. I believe there
16 are more many more unregulated systems with similar critical issues. Small
17 regulated utilities in Missouri currently have issues like lead contamination in
18 drinking water, radio-nuclides in drinking water, and plants discharging waste that
19 has not been disinfected. The improvements necessary to remedy these
20 problems and bring in professional management, when spread over a small
21 customer base, like Hillcrest, will almost always result in large rate hikes.
22

23 **Q. IS THIS A LARGER ISSUE IN THE WATER AND SEWER INDUSTRIES?**

1 A. Yes. While more pronounced in small utilities, issues revolving around the
2 renewal and replacement of aging and failing infrastructure and how to finance
3 these improvements are not just small utility issues. In the latest American Water
4 Works Association 2015 water and wastewater utility rate survey, the number
5 one issue utilities reported they faced is the renewal and replacement of aging
6 water and wastewater infrastructure. The number two issue utilities across the
7 United States of every size reported in this survey is how to find financing for
8 capital improvements. The number four and five issues utilities cited was
9 customers understanding the value of water systems/water services and the
10 value of water resources. An excerpt from survey is included as Rebuttal
11 Schedule JC-3.

12
13 **PAYROLL**

14
15 **Q. ARE THERE SIMILARITIES BETWEEN THE STAFF AND HILLCREST**
16 **CONCERNING PAYROLL?**

17 A. Yes. In the direct testimony, both Hillcrest and the Staff utilize MERIC data to set
18 a salary for Hillcrest's employees and then propose to allocate only fourteen
19 percent (14%) of that salary to Hillcrest for purposes of the revenue requirement.

20
21 **Q. OPC WITNESS ROTH SUGGESTS THAT THE 14% ALLOCATION FACTOR IS**
22 **BASED ON THE RATIO OF HILLCREST CUSTOMERS TO TOTAL COMPANY**
23 **CUSTOMERS. (ROTH DIR., P. 4) IS THAT CORRECT?**

1 A. No. The 14% represents the percentage of time the Company believes will be
2 required of employees, at some point in the future, provided the organization is
3 able to complete additional acquisitions.
4

5 **Q. OPC WITNESS ROTH FURTHER STATES THAT "STAFF ALLOCATED 14%**
6 **OF THE TOTAL WAGES FOR MR. CHALFANT AND MS. EAVES TO**
7 **HILLCREST BECAUSE TIME SHEETS WERE NOT AVAILABLE FOR THOSE**
8 **EMPLOYEES." (ROTH DIR., P. 6) ARE TIME SHEETS NOW AVAILABLE**
9 **FOR MR. CHALFANT AND MS. EAVES?**

10 A. Yes. Those employees began to keep time sheets in November of 2015, and
11 thus have six months of records. The time sheets have been previously provided
12 within the context of the Raccoon Creek Utility Operating Company, Inc. rate
13 case and have been available to both Staff and OPC.
14

15 **Q. HAVE YOU PROVIDED TIME SHEETS FOR A LONGER PERIOD OF TIME**
16 **CONCERNING YOUR ACTIVITIES?**

17 A. Yes. I have provided time sheets dating back to February of 2014.
18

19 **Q. IF THOSE TIME SHEETS WERE USED AS THE BASIS FOR ALLOCATING**
20 **MR. CHALFANT AND MS. EAVES COSTS TO HILLCREST, WOULD THE**
21 **ALLOCATION BE GREATER OR LESSER THAN THE 14% PROPOSED BY**
22 **HILLCREST AND USED BY STAFF?**

1 A. It would be much greater. If Hillcrest's current time by employee were used, the
2 allocation percentage would be closer to 21%, if only operational time is
3 considered. If time spent on the Hillcrest rate case were also considered,
4 currently it is recorded separately; the allocation percentage would be
5 significantly higher than this.

6

7 **Q. DOES HILLCREST CONTINUE TO SUPPORT THE 14% ALLOCATION?**

8 A. Yes. Hillcrest is committed to providing cost effective support for its customers
9 and the allocation provides that.

10

11 **Q. OPC WITNESS ROTH FURTHER SUGGESTS THAT THE HOURLY RATES
12 DERIVED FROM THE MERIC DATA ARE NOT REASONABLE FOR
13 SIMILARLY SIZED UTILITY COMPANIES. (ROTH DIR., P. 5) IS SHE MAKING
14 AN "APPLES TO APPLES" COMPARISON?**

15 A. No. You must remember that, as stated above, only 14% of MERIC salary
16 amount is being allocated to Hillcrest. Thus, the hourly rate being borne by
17 Hillcrest is much lower than the hourly rate being borne by the utility in Ms.
18 Roth's example.

19

20 **Q. WHAT DIFFERENCE IS THERE BETWEEN STAFF AND HILLCREST AS TO
21 THIS ISSUE?**

1 A. In assessing the appropriate salary within the MERIC data, Staff witness
2 Harrison uses the “mean level” of experience, rather than the “experienced level.”
3 (Harrison Dir., p. 6)
4

5 **Q. DO THE ACTUAL SALARIES OF THESE EMPLOYEES IMPACT THIS**
6 **QUESTION?**

7 A. Only in that the actual salaries are greater than those used by both Staff and
8 Hillcrest and are thus being ignored by both Staff and Hillcrest for the purpose of
9 setting the revenue requirement. Thus, both the Staff and Hillcrest proposals
10 benefit the customers when compared to the actual amounts.
11

12 **Q. STAFF WITNESS HARRISON STATES THAT “STAFF SELECTED THE MEAN**
13 **LEVEL BECAUSE, AT THE TIME [STAFF] DEVELOPED [ITS] COST OF**
14 **SERVICE FOR HILLCREST, ALL OF THE EMPLOYEES HAD A YEAR OR**
15 **LESS OPERATING AND RUNNING A REGULATED UTILITY AND THE**
16 **COMPANY WAS JUST BEGINNING TO ESTABLISH ITSELF AS A**
17 **REGULATED UTILITY.” HOW DO YOU RESPOND TO THIS REASONING?**

18 A. I do not think that regulated utility experience is the only thing that should be
19 important to this question. As described in my Direct Testimony, our employees
20 all have substantial years of work experience in various business environments
21 and significant educational backgrounds.
22

23 **Q. DOES USEFUL EXPERIENCE COME IN A VARIETY OF FORMS?**

1 A. I think that it does. There is a commonly heard statement that is credited to a
2 variety of writers that suggests good judgment comes from experience and
3 experience comes from bad judgment. There is some truth to that statement.
4

5 **Q. HAVE YOU BENEFITED FROM SOME INSTANCES WHERE IN HINDSIGHT**
6 **YOU MIGHT HAVE PURSUED A DIFFERENT COURSE?**

7 A. Yes. I mentioned in my direct testimony that I had experience working for
8 Trumpet LLC (Trumpet) as a company officer. I learned much in that role.
9 However, unfortunately, Trumpet ultimately came to an end as a result of being
10 in the building, civil engineering, and development business during the great
11 recession of 2008. Trumpet was ill prepared for an almost overnight huge loss of
12 work that came from the cancellation of projects. I learned a huge amount over
13 the next five years of business from 2008 till 2013, as I tried to keep Trumpet
14 afloat and its employees paid. One of the greatest lessons for me in hind sight is
15 that when there are large issues that need resolved, those issues need to be
16 resolved, in the words of Greg Brenneman, renowned corporate turnaround
17 expert, "Right away, and all at once."
18

19 **Q. HOW DID THAT APPLY IN THE TRUMPET SITUATION?**

20 A. As a younger executive facing the largest recession in modern times, I was
21 hesitant to immediately lay off Trumpet's staff of fifteen full time employees, a
22 majority of whom were in the building industry, in hopes that the economy would
23 turn around. Upon reflection, it can be concluded that Trumpet carried too many

1 people from 2008 all the way through spring 2013, and thereby incurred large
2 debts. Trumpet's actions during that time included taking on bad projects and
3 existing debts from struggling banks to keep Trumpet going on the hope the
4 economy would recover. Circumstances did not change and Trumpet's debt
5 eventually forced the lay-off of all of Trumpet's employees and my declaration of
6 a personal bankruptcy.

7
8 **Q. WHAT WAS THE RESULT OF THAT BANKRUPTCY?**

9 A. Bankruptcy was an emotionally devastating process resulting in my family of five
10 living close to the poverty line for at least a year and half. During that time, much
11 litigation was conducted involving both myself and Trumpet – more than I can
12 possibly remember in detail. Generally, this litigation included creditor attempts
13 to obtain higher priority or to avoid discharge in bankruptcy. This included claims
14 of fraud for the purpose of avoiding discharge. Ultimately, all claims were
15 discharged.

16
17 **Q. WHAT DID YOU LEARN FROM THAT SITUATION?**

18 A. From this business experience I learned very much. First and foremost, I learned
19 about humility and my limitations. I have my own talents, expertise, and
20 experience, and I must work within those skills. Additionally, I grew in fortitude
21 through the painful process of trying to keep a struggling company afloat and
22 employees paid. I also honed on-going technical expertise. Finally, I learned
23 that in order to be successful I need to deal with the realities of any given

1 business situation as they exist on the ground and not based on hoped-for
2 outcomes, in other words, "right away, and all at once." "Right away, and all at
3 once" requires addressing the business case for any particular endeavor, only
4 taking on business that truly needs to be done, and completing the tasks I take
5 on. I think that is what Hillcrest has done in regard to the subject water and
6 sewer systems.

7
8 **Q. HAS YOUR PERSONAL BANKRUPTCY HAD A NEGATIVE IMPACT ON THE**
9 **WORK YOU HAVE PERFORMED IN REGARD TO SMALL WATER AND**
10 **SEWER?**

11 A. I do not believe so. None of the entities from whom I have sought financing or
12 other relationships have asked for my personal financial information.

13
14 **Q. I BELIEVE THERE IS A DENIAL FOR FINANCING FROM GREAT SOUTHERN**
15 **BANK THAT MENTIONS PERSONAL GUARANTEES. HOW DO YOU**
16 **EXPLAIN THAT REFERENCE?**

17 A. Great Southern Bank never sought a personal guarantee from me during the
18 application process. During the conversations and subsequent financing
19 rejection from Great Southern Bank, I learned Great Southern Bank had a very
20 bad experience with a regulated water system, Tri-State Utility. As a result of
21 that experience (which is referenced in the rejection letter), Great Southern Bank
22 had difficulties in spite of personal guarantee(s) from the original owner(s) of Tri-
23 State Utility. My understanding of the Bank's comment in this context was that it

1 believed personal guarantees did not help in regard to its utility financing
2 decisions. Attached as Rebuttal Schedule JC-4 is a copy of the referenced
3 rejection letter.
4

5 **Q. ARE THERE OTHER EXAMPLES OF THINGS THAT YOU WOULD HAVE**
6 **DONE DIFFERENTLY AS A RESULT OF THE EXPERIENCE YOU HAVE**
7 **OBTAINED?**

8 **A.** I would be more careful of my outward profile in life. As a potential public utility
9 provider seeking commission approval for the acquisition of failed utilities, I did
10 not always understand that my personal life could be a public affair. Thankfully,
11 members of the Staff, before I ever became a part of a regulated utility,
12 counseled me in regard to this issue. I have attempted to keep these issues in
13 mind since that time.
14

15 **PROPERTY TAXES**
16

17 **Q. DID STAFF INCLUDE ANY AMOUNTS IN THE REVENUE REQUIREMENT**
18 **FOR REAL PROPERTY TAXES?**

19 **A.** Yes. In the Direct Testimony of Ashley Sarver (p. 3), it was indicated that "Staff
20 has now included \$164 for water and \$164 for sewer in the cost of service for
21 property tax expense."
22

1 Q. STAFF WITNESS SARVER FURTHER STATES THAT STAFF'S NUMBERS
2 ARE USED BECAUSE THEY ARE "KNOWN AND MEASURABLE." SHE
3 DEFINES "KNOWN AND MEASURABLE" TO MEAN "THE UTILITY COSTS
4 UNDER REVIEW ARE ASSOCIATED WITH AN EVENT THAT HAS ALREADY
5 OCCURRED AND THE CHANGE IN COSTS ASSOCIATED WITH THE EVENT
6 CAN BE MEASURED WITH A HIGH DEGREE OF ACCURACY." (SARVER
7 DIR., P. 4) WHAT IS YOUR RESPONSE TO THAT REASONING?

8 A. I believe what Hillcrest is proposing is the known and measurable situation. The
9 circumstances have already changed greatly from those that were in place on
10 January 1, 2015, and it is certain that the taxes used by Staff will not be the taxes
11 paid by Hillcrest. Hillcrest has made over \$1.2 million in improvements to the
12 water and wastewater systems. Those improvements are in service. It is known
13 that they will be taken into account in the property tax Hillcrest will pay this year,
14 as well as future years.

15

16 Q. CAN THE COSTS ASSOCIATED WITH THAT EVENT BE MEASURED WITH A
17 HIGH DEGREE OF ACCURACY?

18 A. Yes. As I mentioned in my Direct Testimony, I have working with the Cape
19 Girardeau County Assessor's office in an effort to make the taxes as affordable
20 as the County Assessor will allow. I recently received feedback providing me
21 with an estimate of property tax costs.

22

1 Q. GIVEN THAT INFORMATION, WHAT WILL THE CAPE GIRARDEAU COUNTY
2 PROPERTY TAXES BE FOR HILLCREST IN 2016?

3 A. It will be at least \$2,972. I say "at least" because it is my understanding that the
4 final tax rate could be raised marginally over the summer.

5

6

CAPITAL STRUCTURE

7 Q. WHAT CAPITAL STRUCTURE DOES STAFF USE?

8 A. Staff witness Griffin uses 25% equity and 75% debt.

9

10 Q. HOW DOES THIS RELATE TO HILLCREST'S ACTUAL CAPITAL
11 STRUCTURE?

12 A. As of September 2015, Hillcrest's actual capital structure was 19% equity and
13 89% debt.

14

15

COST OF CAPITAL (EQUITY AND DEBT)

16

17 Q. STAFF WITNESS GRIFFIN IDENTIFIES THE STAFF SUGGESTED COST OF
18 EQUITY AS OF DECEMBER 2015 TO BE 12.88%, AND INDICATES THAT IF
19 THE STAFF WERE TO UPDATE BASED ON DATA THROUGH MARCH OF
20 2016, ITS RECOMMENDED COST OF EQUITY WOULD BE 14.13%. (GRIFFIN
21 DIR., P. 2-3) WHAT IS YOUR REACTION TO STAFF'S COST OF EQUITY
22 POSITIONS?

1 A. I certainly would prefer the updated cost, as that would reflect more recent data.
2 However, I believe the range of the Staff cost of equity recommendations is
3 reasonable.
4

5 **Q. STAFF WITNESS GRIFFIN IDENTIFIES THE STAFF SUGGESTED COST OF**
6 **DEBT AS OF DECEMBER 2015 TO BE 8.88%, AND INDICATES THAT IF THE**
7 **STAFF WERE TO UPDATE BASED ON DATA THROUGH MARCH OF 2016,**
8 **ITS RECOMMENDED COST OF DEBT WOULD BE 14.13%. (GRIFFIN DIR., P.**
9 **2-3) WHAT IS YOUR REACTION TO STAFF'S COST OF DEBT POSITIONS?**

10 A. For the reasons stated in my Direct Testimony, I believe that Hillcrest's actual
11 debt cost (14%) should be used. To do otherwise, is to assume financing that
12 just is not available to Hillcrest at this time.
13

14 **RATE CASE EXPENSE**

15 **Q. WHAT RATE CASE EXPENSE HAS HILLCREST INCURRED AS OF THIS**
16 **DATE?**

17 A. \$13,995.65, as of May 11, 2016.
18

19 **Q. WHAT IS INCLUDED IN THAT EXPENSE?**

20 A. \$11,478.63, in attorney fees for services provided by Brydon, Swearngen &
21 England P.C.; \$2,517.02, in consulting fees for services provided by Johansen
22 Consulting Services and expenses (travel).
23

1 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

2 A. Yes, it does.

Hillcrest Water Usage by month per customer

5/10/2016

| Beginning Date | End Date | Usage | No. Cust. | Ave/Cust/mo |
|-------------------|------------|-------------------|-------------|-------------|
| 4/1/2016 | 4/30/2016 | 767209 | 241 | 3183 |
| 3/1/2016 | 3/31/2016 | 958169 | 242 | 3959 |
| 2/1/2016 | 2/29/2016 | 679889 | 242 | 2809 low |
| 1/1/2016 | 1/31/2016 | 756609 | 240 | 3153 |
| 12/1/2015 | 12/31/2015 | 984792 | 241 | 4086 |
| 11/1/2015 | 11/30/2015 | 755818 | 244 | 3098 |
| 10/1/2015 | 10/31/2015 | 881706.5 | 246 | 3584 |
| 9/1/2015 | 9/30/2015 | 1043860 | 245 | 4261 |
| 8/1/2015 | 8/31/2015 | 1017638.5 | 241 | 4223 |
| 7/1/2015 | 7/31/2015 | 911619 | 241 | 3783 |
| 6/1/2015 | 6/30/2015 | 1159181 | 241 | 4810 high |
| 5/1/2015 | 5/31/2015 | 969638.5 | 244 | 3974 |
| | | <u>10886129.5</u> | <u>2908</u> | 3744 |
| Ave Annual | | 907177.4583 | 242.333333 | 3744 |

STATE OF MISSOURI
DEPARTMENT OF NATURAL RESOURCES

Jeremiah W. (Jay) Nixon, Governor • Sara Parker Pauley, Director

www.dnr.mo.gov

APR 21 2016

Mr. Josiah Cox, President
Hillcrest Utility Operating Company Inc.
500 N West Plaza Drive
Suite 500
Saint Ann, MO 63074

RE: Hillcrest Utility Operating Company Inc, Public Water System ID# MO4036038
Administrative Order on Consent No. WPCB-2014-1316

Dear Mr. Cox:

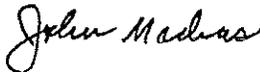
Hillcrest Utility Operating Company Inc. has successfully completed the requirements set forth in Administrative Order on Consent (AOC) No. WPCB-2014-1316, signed and effective on April 6, 2015. A department approved chlorination system was installed as outlined in the AOC and chlorine residuals are monitored as required.

Hillcrest Utility Operating Company Inc. is no longer liable for the suspended penalties outlined in section IV, item U of the order.

Your cooperation during the compliance period is appreciated. If you have questions you may contact Ms. Sarah Hearne of my staff by phone at (573) 751-4414 or via mail at the Missouri Department of Natural Resources, Water Protection Program, Public Drinking Water Branch, P.O. Box 176, Jefferson City, Missouri 65102-0176.

Sincerely,

WATER PROTECTION PROGRAM



John Madras
Director

LD/sha

c: Mr. Brad Ledbetter, Southeast Regional Office
Ms. Hannah Humphrey, Community Services



APR 25 2016

Part II

SOTWI survey participants were asked to rate the importance of a range of challenges on a scale of 1 (unimportant) to 5 (critically important). The top 10 issues for 2015 are shown in Table II-1, ranked by average scores and the percentage of respondents who scored the issue as critically important.

As Table II-1 shows, financial issues related to water system stewardship were rated the most important by utility employees. This includes the need for renewal and replacement of aging water and wastewater infrastructure (#1 issue), financing for capital improvements (#2), public understanding of the value of water systems and services (#4), public understanding of the value of water resources (#5), and cost

recovery (#7). Financial aspects of system stewardship are also embedded, albeit sometimes indirectly, within all of the top 10 industry issues.

Issues of system stewardship continue to be significant because many water and sewer systems built and financed by previous generations are approaching or have exceeded their useful lives. Because previous budgeting approaches may have included inadequate revenues to fully cover costs, some municipal utilities have deferred necessary maintenance. Even those systems that have acted as good stewards by planning for asset renewal or replacement can find it difficult to secure adequate funding for capital projects or to win public support for funding these efforts.

Table II-1 Issues facing the water industry as ranked by 2015 SOTWI utility respondents

| Rank | Category | Score (1-5) | Critically important | # of Utility respondents |
|------|--|-------------|----------------------|--------------------------|
| 1 | Renewal & replacement of aging water and wastewater infrastructure | 4.59 | 64% | 913 |
| 2 | Financing for capital improvements | 4.44 | 56% | 921 |
| 3 | Long-term water supply availability | 4.43 | 58% | 911 |
| 4 | Public understanding of the value of water systems and services | 4.36 | 51% | 919 |
| 5 | Public understanding of the value of water resources | 4.28 | 45% | 914 |
| 6 | Watershed/source water protection | 4.21 | 43% | 922 |
| 7 | Cost recovery (pricing water to accurately reflect its true cost) | 4.16 | 36% | 891 |
| 8 | Emergency preparedness | 4.11 | 35% | 914 |
| 9 | Compliance with current regulations | 4.07 | 35% | 896 |
| 10 | Compliance with future regulations | 4.06 | 35% | 893 |



June 9, 2013

Dynamic Water Resources, LLC
c/o: Josiah Cox
3636 S. Geyer Rd., Suite 100
St. Louis, MO 63127

Josiah,

We appreciate the opportunity to review your financing needs and thank you for your time last week. After we talked, I spent some time on the phone with our attorney handling the existing water company transaction the bank is involved in, and also with our chief credit officer. Our attorney indicated the process with the PSC has not gone smoothly. Our credit officer indicated that based on our experience with that deal, and on other factors like the lack of personal guaranties, he did not think we would be a good fit for your deals.

Regards,



Mike Lemons

Vice President – Commercial Lending