BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Lincoln County Sewer & Water, LLC for Approval of a Rate Increase	)))	**File No. SR-2013-0321**

In the Matter of the Application of Lincoln County Sewer & Water, LLC for Approval of a Rate Increase	)))	**File No. WR-2013-0322**

LINCOLN COUNTY SEWER & WATER, LLC'S

BRIEF

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LCSW'S BRIEF

COMES NOW Lincoln County Sewer & Water, LLC ("LCSW" or "Company") and, as its Brief, respectfully states as follows to the Missouri Public Service Commission ("Commission"):

INTRODUCTION

"There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment." *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

> In 1925, the Missouri Supreme Court stated:
>
> The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. * * * These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

State ex rel. Washington University et al. v. Public Service Commission et al., 308 Mo. 328, 344-45, 272 S.W. 971, 973 (*en banc*).

LCSW was granted certificates of convenience and necessity to provide water and sewer service by a Commission order issued on June 27, 2012 (Cases Nos. WA-2012-0018 and SA-2012-0019). Its tariff sheets became effective for regulated service on July 20, 2012.

LCSW operates water and sewer systems in two subdivisions in Lincoln County – Bennington and Rockport. It currently serves fifty (50) water customers and fifty-one (51) sewer customers in Bennington and seventy-two (72) water and sewer customers in Rockport. These four systems all have separate rates. The subdivisions contain $200,000 to $300,000 homes. (Tr. 331)

At the time LCSW received its certificates, there were no water meters in place at either Bennington or Rockport. (Exh. LCSW 3, p. 4) LCSW's customers initially received all the water they could use for a set price. This was a particular issue on the Bennington system which, from time to time, could have capacity issues associated with the customers' usage patterns.

LCSW decided to install meters for all customers. This meter installation took place between July and September, 2012. (Exh. LCSW 3, p. 4) It allowed the Company to bill all customers for their actual usage. Installing meters for all customers also eliminated any issues that might have resulted from why certain customers were or were not selected for various phases of meter installation.

LCSW initiated this case for the purpose of having the meters, meter installation and other investments reflected in the Company's rates, along with other operation and maintenance cost increases. (Exh. LCSW 3, p. 4)

The Staff, as of October 31, 2013, *includes in rate base the Staff figures for the remote read meters, the meter reading devise and the billing program*. (Exh. Staff-11) Even with these positions, the Staff case results in a net DECREASE for the Company, as of that date:

SUBDIVISION/SYSTEM	STAFF RATE INCREASE/(DECREASE) AS OF OCTOBER 31, 2013
Bennington Sewer	($1,421)
Bennington Water	$4,173
Rockport Sewer	($3,338)
Rockport Water	$441
NET RATE INCREASE/(DECREASE)	**($145)**

INFORMATION/DOCUMENTATION ISSUES

Staff discussed in its opening statement the information/documentation issues it claimed to have experienced during the course of this case. Certain points are worth reiterating in regard to this Staff opinion.

LCSW is a "new" entity. The entity was formed on May 9, 2011, for purpose of the certificate cases filed on July 19, 2011. (Stipulation and Agreement, Case No. WA-2012-0018) LCSW began to provide service when its first tariff sheets became effective on July 20, 2012. (Exh. LCSW-3, p. 2, 3) While it may have been nice to have had twelve months of data related to LCSW's regulated service, it was not possible as LCSW did not exist for a twelve month period until July of 2013. (*Id.* at p. 3) LCSW had made a very significant investment. Waiting to file a rate case until after July 2013, would have merely prolonged the time period before the Company could have that investment considered by the Commission.

All expense information that LCSW had (electric bills, testing, etc.) was provided. (Exh. LCSW-2, p. 6) Staff also indicates that information was provided for the time period subsequent to the date of LCSW's certification. (Exh. Staff- 8, p. 3) Moreover, Staff was provided with pre-regulation information during the certificate case. (Exh. Staff- 8, p. 3) Presumably, that information was still available to Staff.

Some of the information Staff witness Hanneken says she is missing from periods prior to LCSW's operation never existed and Ms. Hanneken knew it never existed before this case started (Tr. 276) - for example, pre-certification time sheets (Tr. 275-276, 283), "employee" job descriptions (Tr. 282-283), and billing registers pre-certification (Tr. 283-284). Ms. Hanneken indicated that she continued to ask for these items just in case there were items "overlooked" in the prior case. (Tr. 285)

Pre-certification document problems are not something that is unique to this case, or to this Company. The question is how the Company reacts as it moves forward. LCSW is in its infancy as a regulated utility. As time passes, these documentation issues should become less prevalent. (Exh. LCSW-2, p. 6)

That said, there are issues that seem to need a little common sense to be applied in as the Company moves forward. For example, LCSW's 122 water and sewer customers are spread between two water systems and two sewer systems. Mr. Kallash explained that Staff wants him to account for all his expenses at the individual system level. (Exh. LCSW-2, p. 7) Ms. Hanneken confirmed this Staff position in response to questions from Staff counsel Moore:

> . . . in addition, because they do have different rates, we have to track each separate subdivision's costs specifically related to that subdivision. Otherwise, you're going to have cross-subsidization between the different systems. So as with any of the expenses, we have to allocate it to the four systems.
>
> You know, if we have just one expense, say something that would be for all the systems, like pens and pencils in the office, we really can't say that they're going to go to this system or this system. So we just take the cost of those pens and pencils and we divide it out amongst the systems

(Tr. 289)

The result of this is to essentially ask the Company to maintain four sets of books for its 122 customers. Mr. Kallash explained that one consequence of this approach is that he has been told he needs to allocate the cost of each 46 cent stamp among the four systems (Exh. LCSW-3, p. 7). In regard to the allocation of another small item – paper towels – Mr. Kallash was told he should keep four rolls in his truck – one for each of the systems, so these costs can be kept separate. (Tr. 174-175) LCSW certainly understands that it must keep records of its expenses. (Exh. LCSW-3, p. 7) However, it wasteful and nonsensical to try and specifically allocate costs, without regard to size of the expense, in a system of 122 customers.

LCSW understands that when it became a public utility in July of 2012, its records became subject to inspection by the Commission Staff and the Office of the Public Counsel in accordance with Missouri statutes (for example, Section 393.140(7) and (8), RSMo). (Exh. LCSW-2, p. 5) Moreover, LCSW understands that the Commission has rules related to public utility record retention with which LCSW must comply as a public utility (for example, Commission Rules 4 CSR 240-61.010 and 4 CSR 240-50.020). (*Id.*) Having said this, those records that were not kept for operations prior to the birth of LCSW will not suddenly appear. (*Id.* at p. 7) LCSW can only do these things on a going forward basis.

ARGUMENT AS TO ISSUES

In the following pages, LCSW will set forth its arguments in regard to each of the issues that were identified on the joint list of issues and discussed in the statements of position of the parties.

1. **Meters/Meter Reading**
   a. What is the appropriate amount, if any, to include in rates for the purchase, installation, and operation and maintenance of the Company's automated meters?
   b. If the automated meter costs are not included in rates, what amount of non-automated meter purchase, installation, and operation and maintenance costs should be included in rates?
   c. If the automated meter costs are not included in rates, what amount of meter reading costs should be included in rates?

Background

A good place to start with the review of the Company's significant investment in its meters and meter reading equipment is what is *not* challenged by Public Counsel. While there was discussion about LCSW's choice to provide meters for all customers as a part of a single project, there is no allegation that LCSW was prohibited or imprudent in doing so. In regard to the meters and meter reading equipment, there is no allegation that LCSW paid too much for this type of equipment. There is no allegation that the equipment fails to perform as intended and designed. There is no allegation that the process used to install the equipment was improper or abnormally costly. The only real complaint lodged by the Public Counsel is that it believes LCSW should have installed a different type of meter, with fewer functions, at a hypothetical purchase price and cost of installation that was estimated by Staff at the time of the Company's certificate cases, without regard to the actual installation costs incurred by LCSW.

Additionally, Staff witness Merciel stated that to his knowledge, the question of the appropriateness of remote read meters is an issue that has never previously been before the Commission. (Tr. 135) Certainly, the Commission has no rules or standards of service regarding remote read metering. (*Id.*)

The Missouri Supreme Court stated many years ago 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." *State ex rel. City of St. Joseph v. Public Service Commission*, 325 Mo. 209, 223, 30 S.W.2d 8, 14 (banc 1930).

Public Counsel is inappropriately challenging management's decision to install remote read meters. This is a proven technology, which provides extra features for both the customers and the Company, at an appropriate price for that technology.

Use of Remote Read Meters

Rather than a multi-year approach that would have resulted in some customers being metered and others not being metered, the Company decided to install meters in both Bennington and Rockport in a single project. (Exh. LCSW-1, p. 3)

The Company chose to install remote-read meters. LCSW witness Johansen testified that these meters have advantages over other meters in that they provide the ability to determine whether there is unusual customer usage (either continuous leak or intermittent leak) such as might be caused by a leak on customer facilities; the ability to identify backflow through the meter; the ability to produce a 96-day record of customer usage; and the ability to identify days during which a customer had zero usage. All of these features can be advantageous to the customers and have in fact resulted in savings to the customers by identifying leaks on customer facilities. (Exh. LCSW-1, p. 4-5; Tr. 83)

Staff witness Merciel generally agreed with Mr. Johansen's testimony and further stated that some benefits of the meters are intangible or not quantifiable. (Exh. Staff-4, p. 25) In addition to the points made by Mr. Johansen, Mr. Merciel stated that the "remote reading capability can also be a time-saving tool available to the utility in managing its obligation to read every water meter each billing period." (*Id.*)

Mr. Merciel further discussed some of the advantages provided by the automated meters during the hearing. He explained that the meters themselves have the capability of recording the water usage either daily or hourly, so you can narrow down any unusual events. The meters are capable of going back for the past 90 days or so and see how that customer used water, whether it was a leak for several days or the whole billing period or one day. (Tr. 123, 128-129)

Mr. Merciel further indicated that this information allows the Company to narrow down leaks and usage to a certain time frame and to thereby narrow down what happened. (Tr. 129-130) This information that is helpful to both the Company, Staff, and the customer in pursuing high bill complaints. (*Id.*)

Mr. Merciel explained that the Commission gets high bill complaints frequently. With a standard meter, you know usage for one month and usage for another month, but you do not have any idea what happened otherwise. (Tr. 124) The meters purchased by LCSW provide additional information that is helpful in narrowing down the possible cause – information on a daily basis or an hourly basis. (Tr. 124, 125) More specifically, Mr. Johansen identified two examples of the many situations where the capabilities of the meters have already been used to identify and fix significant leakage issues for LCSW customers, (Tr. 83-84) thereby saving customers substantial dollars.

LCSW is not the only Missouri water system to have installed remote read meters. This is a technology that is successfully used in many other systems in Missouri. (Tr. 82) In response to a LCSW data request, Staff indicated that to "the best of Staff's knowledge, the following utilities, regulated and unregulated, have some level of AMR technology in use or in the process of installation:

Lincoln County
Tri-States
MAWC
Raytown
Callaway PWD 1
Callaway PWD 2
City of Hermann
City of Wentzville
PWD No. 9 of Cass County - Harrisonville
Monroe County PWSD #2
Marion County
Savannah
PWSD #1 of Franklin County in Krakow
Camden County PWSD #1"

(Tr. 130-132, Exh. LCSW-5). While this is a list of systems Staff was aware of, Staff witness Merciel indicated that it is not necessarily an exhaustive list. (Tr. 131-132)

At the hearing, the Commission directed Staff to "supplement the record with an exhaustive list of regulated water and sewer companies, the number of customers and whether or not that company has an automated meter reading system." (Tr. 144) In an attempt to assist Staff in this endeavor, LCSW supplied Staff with a list of systems to which LCSW's meter supplier (Schulte Supply) indicated it had sold remote read meters.

On November 25, Staff counsel informed LCSW as follows:

> Staff has assembled its list of regulated utilities with AMR usage and decided it would be too burdensome to attempt an exhaustive list of all such water companies in the state, as the Judge mentioned, so we will not be using the info you sent. I didn't want you to be surprised that it isn't included tomorrow in case you would choose to use it yourself.

Accordingly, attached hereto as **Appendix 1** is the list of systems provided to Lincoln County by its supplier.[1] Because the supplier's territory includes Missouri and Illinois, there are systems in both states listed. Most of the Missouri systems are on the first two pages. However, there are a couple of Missouri systems mixed in with the Illinois systems in the later pages (such as Elsberry).

Project Costs

The costs of the meter installation project were as follows: 1) – Meters - $32,867; and 2) Parts & Installations - $32,698. (Exh. LCSW-1, p. 4)

As a part of installing the remote-read meters it chose to install, the Company needed to purchase a remote meter reading device. The meter reading device cost $9,438 and training regarding the use of the device cost $1,500.

Public Counsel Position

Public Counsel's position as to whether or not LCSW's remote meter purchase and installation was prudent is sponsored by Mr. William Addo. Mr. Addo is an accountant. (Tr. 139-140) He is not an engineer. (*Id.*) He has never designed a water system and he has never operated a water system. (*Id.*) Mr. Addo has no experience in regard to meter installation. (Tr. 141)

Mr. Addo "adopted" Staff estimates from the Company's certificate case for his proposed "standard" meter and installation costs. (Tr. 140-141) Mr. Addo did not seek

[1] This information was provided by Bob Hettick – Electronic Specialist, Schulte Supply (314-304-7914 – cell).

bids as of July 2012 (the date the purchase and installation of meters was begun). (Tr. 141)

The Staff estimates were not agreed to in the stipulation from the certificate case. (*Id.*) In fact, there was disagreement about those estimates at the time of the certificate case. (Tr. 132) Ultimately, Mr. Merciel and others generally indicated that what would be examined in a rate case would be the actual cost of meters and meter installations. (Tr. 133)

At the time Staff's estimates were created, no meter installations had begun. (Tr. 141) One need only to compare those estimates with the actual cost of installation to see that they have little validity. The total estimated cost for meters and installations was $35,800. The actual cost of parts and installation ONLY (not the meters) was $32,698. The Staff estimate ultimately barely covered the actual cost of parts and installation. (Exh. LCSW-1, p. 4)

Costs, In the Alternative

As stated above, the "estimated" standard meter cost (which includes both meters and parts and installation), barely covered the actual cost of parts and installation. (Tr. 85, 86, 87-88) Thus, even if the Commission were to find that LCSW's purchase of automated meters was not prudent, the estimates used by the Public Counsel would have to be adjusted to consider the actual installation costs. (*Id.*) This is because the installation process for standard meters and automated meters is largely similar. (*Id.*) Staff witness Merciel confirmed that there are costs incurred, such as a meter pit, whether the system is an automated or manual read system. (Tr. 126) There is also a yoke, lid, rim and other miscellaneous parts that are necessary.

The actual costs of parts and installation for the meters was $32,698. (Exh. LCSW-1, p. 4) Thus, any alternative to the actual meter and meter installation cost should include in rate base $32,698, plus the cost of standard meters multiplied by 122 meters.

Additionally, if the Commission does not include the costs associated with the remote-read meters and the meter reading device, meter reading expenses should be added to the revenue requirement. The meter reading expenses should be calculated by multiplying $2.75 times the number of meters (122) times the number of months (12). The figure of $2.75/meter/month is based on the bid LCSW received for such services. (Exh. LCSW-1, p. 6; Tr. 81-82) This was a written bid from a professional meter reader (Tr. 77) that was provided to Staff and OPC. (Tr. 79) In this scenario, the Staff's and OPC's estimated meter reading expenses should be ignored as there simply is no basis for the estimate and no connection to the actual installation.

Comparison of Standard Meter v. Remote Read Meter Cost

At the hearing, the Commission asked the parties to include in their briefs a comparison of the cost to each customer associated with the use of the remote read meters as opposed to “standard” meters. LCSW has prepared the comparison attached hereto as **Appendix 2**.

In Appendix 2, LCSW has attempted to isolate the meter cost difference from the other elements of the installation, on a “per customer” basis, without regard to an individual customer’s usage. For example, there would be an installation cost whether standard meters or automated meters were installed. That installation cost would be the actual cost of installation, not the estimated cost.

Additionally, certainly other costs would be necessary in the absence of the automated meters. These costs include the cost of manually reading each meter on a monthly basis and manually inputting the manual read data into a billing program. (Tr. 81)

When the above-noted items are considered collectively, the difference for customers on a monthly basis is approximately <u>$1.17</u>, per month, per customer. *See* **<u>Appendix 2</u>**.

2. **Billing Program & Billing Expenses**
    a. What is the appropriate amount to include in rates for the Company's billing program?
    b. If the billing program is not included in rates, should additional payroll expenses be included for billing and related activities?

BACKGROUND

The Company purchased a billing program at a cost of $3,745.00. This amount should be included in plant in service and appropriate depreciation expense and taxes added to the cost of service. (Exh. LCSW-1, p. 7)

Staff has included the cost of this program in its cost of service. (Exh. Staff-8, p. 11) Public Counsel argues that the billing program is connected to the automated meters and, thus, if the automated meters are disallowed, so too should the billing program be disallowed. (Exh. OPC-2, p. 15-16)

Billing Program Should Be Included

The billing program purchased by the Company is independently used and useful in the Company's operations and is not exclusively related to the Company's remote-read meters. (Tr. 148)

The billing program is used to create the Company's monthly bills, track customer payments, track the status of customer accounts, create late notices, calculate late fees, create disconnect and reconnect orders, and create disconnect letters. (Exh. LCSW-1, p. 7) Additionally, the billing program is used as a data base for customer contact info, account history, water usage history, service locations, and meter information (install date, size, serial number, etc.). (*Id.*)

As a result, the Company believes the billing program cost should be included in plant in service and appropriate depreciation expense and taxes added to cost of service regardless of what conclusion the Commission reaches in regard to the type of meters the Company installed.

Alternate Cost

If the Company's billing program is not included in plant in service, there should be a recognition of the additional costs associated with the fact that, in the absence of the billing program, the Company would be required to manually prepare its bills, manually track customer payments, manually track the status of customer accounts, manually create late notices, etc. (Exh. LCSW-1, p. 7) LCSW witness Johansen testified that an additional 12 hours per month should be added when annualizing the payroll expense for LCSW office personnel, if a different billing program is assumed to be used by LCSW. (*Id.*)

Mr. Johansen is currently the court-appointed receiver for Rogue Creek Utilities, which is a company that has approximately 100 customers and has a water and sewer system. (Tr. 148) He is also a Commission-appointed interim receiver for MPB, Inc. and PCB, Inc., which are both Commission-regulated companies. (*Id.*) In these positions, Mr. Johansen has had the opportunity to perform billing functions without the benefit of a program such as the one used by LCSW. (*Id.*) It is this personal experience with billing for small water and sewer utilities upon which Mr. Johansen bases his estimate that billing would take an additional 12 hours of work per month in the absence of the subject billing program. (Tr. 146; Exh. LCSW-2, p. 5)

3. Land Ownership and Valuation

LCSW indicated at hearing that it was no longer pursuing this issue. (Tr. 46)

4. Rate Base

a. What are the appropriate beginning balances for the Company's rate base?

Mr. Johansen's review of the beginning balances reflected in the Company's certificate cases reveals that not all of the costs associated with the original construction of the water and sewer facilities were used in arriving at that rate base. (Exh. LCSW-1, p. 14) This includes the costs associated with: (1) engineering fees; (2) the structures that house the wells and/or storage tanks; (3) the structures that house the sewage treatment plant blowers; and, (4) the base rock and concrete pads for the water storage tanks. (*Id.*) The absence of these items ignores at least another $75,000 to $100,000 in rate base . (Tr. 160) However, Mr. Johansen has documentation that would allow him to be more specific. (*Id.* at 160-161)

These are items that would have existed at the time of the certificate case. (Tr. 156) In some cases they even would have been obvious with a cursory review of the facilities (Tr. 159) (structures that house the wells, storage tanks and sewage treatment blowers).

Some of the plant was put in 16 years ago. (Tr. 175) When Staff was doing its review of the plant numbers, Mr. Kallash did not have receipts or even the cancelled checks. (*Id.*) Accordingly, he went to the bank to get copies of checks and provided those to Staff. (*Id.*) It was Mr. Kallash understanding that because he could not provide receipts related to this plant, Staff would not put it into rate base. (Tr. 176) This includes recreated receipts. If a vendor provides a copy of an original (16 year old) receipt, the Staff will consider it. (Tr. 184) However, if the receipt from a vendor has been recreated, Staff would not necessarily accept it. (*Id.*)

Staff witness Hanneken confirmed that it is not Staff's practice to include plant in service based on cancelled checks. (Tr. 179) So, when Staff says there is no documentation, there may have been cancelled checks provided to Staff. (*Id.*) If Staff doesn't believe it has sufficient documentation, Staff deems the items to have no value. (Tr. 180)

There is not really a dispute that investment related to certain LCSW plant has not been accounted for in Staff's rate base. Regardless of the process that got us to this point, it is important from a regulatory viewpoint and a fairness viewpoint to ensure that the plant and rate base balances are accurately stated. (Exh. LCSW-2, p. 12) Accordingly, the Commission should direct the parties to re-analyze the Company's plant in service balances that were used to establish the beginning rate base balances in the certificate cases, for the purpose of establishing an updated rate balance for purposes of the Company's books and records and future rate cases.

5. **Capacity Adjustments (Rockport)**
What should be the adjustment to rate base for excess capacity in the Company's Rockport facilities?

Introduction

The Rockport water and sewer facilities were built to serve the overall development; however, the development has yet to fully build out. (Exh. LCSW-1, p. 12) To address this situation, Staff proposes capacity adjustments related to the well pump, water storage tank and sewer treatment facility found in the Rockport subdivision. (Exh. Staff-4)

LCSW does not dispute that it is reasonable to make capacity adjustments. However, the most appropriate approach to make these adjustments is that described by LCSW witness Johansen. His approach utilizes the units upon which the initial permits were granted, without adding a hindsight element associated with usage used by Staff. That hindsight information was not known at the time the plant was constructed and could not be used in the design of the system or, more importantly, a DNR permit could not be obtained on this basis.

Plant at Issue

Staff witness Merciel indicates that the Rockport plant elements at issue are "in service" and "used and useful in their entirety." (Exh. Staff-4, p. 24) There is no allegation that the initial construction of these facilities was not prudent.

Normally, in considering whether constructed plant should be included in rate base, the Commission looks to the following standard found in *In the matter of Union Electric Company of St. Louis, Missouri,* 27 Mo. P.S.C. (N.S.) 183, 194 (1985).

> In reviewing UE's management of the Callaway project, the Commission will not rely on hindsight**.** The Commission will assess management decisions at the time they were made and ask the question, 'Given all the surrounding circumstances existing at the time, did management use due diligence to address all relevant factors and information known or available to it when it assessed the situation?'

However, Staff proposes “capacity adjustments” based on its position that these facilities are “oversized for present use.” (Exh. Staff-4, p. 10)

Consequence of Adjustments

As a starting place, it is important to remember that there is no rule that a utility customer should or must only pay for precisely the amount of plant they are using. It would be economically inefficient, cumbersome and probably imprudent to construct only precisely that amount of plant that will be used by existing customers (not to mention the fact that DNR would not allow this). Utility plant in that scenario would constantly be behind the usage and attempting to catch up.

Having said this, LCSW acknowledges that in the “new development” situation there are also circumstances where a reasonable approach must be applied in order to balance the utility’s ability to recover on its investment with the rate to be paid by the customer.

This is especially important for the utility as the adjustment proposed by Staff will result in a permanent loss of LCSW’s potential to recover its investment. Staff witness Merciel suggests that “Staff's disallowance is fairer to the ratepayers and also allows Lincoln County to recover additional capital expense as customer growth occurs and more capacity is utilized.” (Exh. Staff-4, p. 16) However, this suggestion falls apart when one considers how Staff proposes to treat this capacity adjustment (*See also* the following Plant Held for Future Use Issue).

Under Staff's approach, in the current case, the Company receives neither a return on nor a return of (depreciation expense) that portion of its investment deemed to be "excess capacity." (Tr. 350-351) However, the impact of this adjustment is more far ranging than just the current case. That is because even though there is no recognition of the depreciation expense in the revenue requirement, Staff still accumulates depreciation reserve related to the excess capacity plant. (Tr. 351) Thus, Staff's approach guarantees that the Company will never recover a return on or a return of some portion of its plant investment. (Tr. 351-352, 355) In other words, no matter what the speed of future growth, there is rate base and recovery of and on that rate base that is being permanently lost yesterday, today and tomorrow. (Tr. 352)

Therefore, while a capacity adjustment may be appropriate, the Commission should be very careful in how it structures that adjustment, given the permanent and irreversible consequences related to the Company's investment in plant.

Further, LCSW alleged and Staff acknowledged that Staff's approach could very well lead to the absurd situation where Department of Natural Resources (DNR) requirements force LCSW to construct additional facilities at the same time the Commission is not allowing the Company to earn a return on its existing facilities. (Exh. LCSW-1, p. 13) Staff witness Merciel described this possibility as "very likely" when he responded by stating "absolutely this situation could occur, and in fact could very likely occur as more home construction occurs in Rockport, depending on future changes . . . ." (Exh. Staff-4, p. 14) It is unclear what public interest would be served by placing a utility in this trap.

Staff Adjustment

The Staff's proposed capacity adjustments are based on now-known customer usage amounts. (Exh. LCSW-1, p. 12) Based on these amounts, Staff recommends that 87% of the well pump investment, 70% of the water storage tank investment, and 77% of the sewer treatment facility investment found in the Rockport subdivision should be deemed to be excess capacity (or disallowed). (Exh. Staff-4, p. 7-9)

Staff's approach is not an appropriate method for determining capacity adjustments in that the initial design and permitting of the facilities was in essence based on number of customers. Additionally, basing adjustments on now-known usage amounts inserts a hindsight analysis into the process in that this information was not available when the plant was permitted and constructed.

In calculating his capacity adjustments, Staff witness Merciel uses now-known customer water usage amounts. (Exh. LCSW-2, p. 11) However, this is information that was not available when the facilities were designed (*Id.*) and is not allowed by DNR. The facilities were designed using the "standard" water usage levels set out in the Department of Natural Resources (DNR) design standards. (*Id.*)

The best example of the difference this makes is found in the adjustment related to the sewage treatment plant. (*Id.*; Tr. 341-342) This plant was designed with a capacity of 78,000 gallons/day according to the DNR's design standards (3.7 persons per lot and an assumed usage of 100 gallons per day population equivalent), in order to provide service to 210 customer connections for the overall development. (*Id.*; Tr. 342) Based on current usage levels, Mr. Merciel assumes that the sewage treatment plant has capacity to serve *322* customer connections. (Exh. Staff-4, p. 8-9) This hindsight design approach is something that is beyond the Company's permit, not allowed by DNR and was simply not available for the design of these facilities.

Moreover, it should also be pointed out that Staff's capacity adjustments are not related to what it thinks *should have been* invested in the subject plant. In other words, even though Staff only allows 30% of the cost of the water storage tank in rate base, this does not mean that Staff believes a water storage tank should have been built for 30% of the cost. (Tr. 349) This is partially because there are economies of scale in the construction of water and sewer plant. (*Id.*) You cannot say that just because a utility only needs 30% of its existing capacity, that its original cost to construct should have been 30% of the original cost. (Tr. 349-350) Staff's adjustment has nothing to do with the cost of a different or more appropriate facility. (Tr. 350) It is purely a "usage" adjustment.

The Company is not challenging the application of a capacity adjustment based on the current number of customers as compared to the design number of customers (72 v. 210). (*Id.*) However, Mr. Merciel has essentially adjusted the design number of customers for the plant based on now-known customer water usage data (which is not allowed by DNR), and has then compared the current number of customers to his *adjusted* design customer equivalents to calculate his capacity adjustment. (*Id.*) This adjustment is simply not appropriate, nor is such a hindsight approach fair to the Company. (*Id.*)

Lastly, to the extent that the Staff alleges that some methodology from the Company's certificate cases should be continued, it must be pointed out that no capacity adjustment methodology was identified, nor agreed to, in the Cases Nos. WA-

2012-0018 and SA-2012.0019 Stipulation and Agreement. In fact, the Stipulation states expressly in paragraph 24 that "[i]n arriving at the amount of the rate base specified herein, no party has agreed to any particular ratemaking principle."

LCSW Adjustment

A more appropriate way to make these adjustments is the approach described by LCSW witness Johansen. Mr. Johansen computed capacity adjustments based on an analysis of the number of customers that the facilities were designed/permitted to serve and the current number of customers served. (Exh. LCSW-1, p. 13-14)

The Company's DNR permits for the Rockport water and sewer facilities are essentially based on number of customers, which result from specific customer usage amounts that are used in the design of the facilities. (Exh. LCSW-1, p. 13) The Department of Resources (DNR) final inspection report, dated December 27, 2007, states very clearly that "this approval is only valid for 120 lots in Phase I of the development." (Exh. Staff-4, Sch. JAM-3) There is no provision in the DNR approval made for later assessment of actual gallons used.

Because lots/customers is the basis for the initial construction, any capacity adjustments for those facilities should be based on a similar analysis of the number of customers that the facilities were designed/permitted to serve and the current number of customers served. (*Id.*) This results in the use of 120 "design" customers for the well pump and 210 "design" customers for the water storage tank. (Id.) For the sewage treatment plant, 210 "design" customers should be used. (Tr. 75; Exh. LCSW-1, p. 13)

Mr. Merciel's criticism of the pump and motor that have been installed ignore the fact that variations in the water table will impact the pump's ability to perform. Thus, a single observation will not accurately assess the size pump or motor that will be required in order to provide service on every day of the year. Some of this variation can be seen by Mr. Merciel's own testimony. He makes his proposed adjustment based on a pumping capacity of 420 gallons per minute observed. (Exh. Staff-4, p. 7) The Department of Natural Resources "final inspection" report, dated December 27, 2007 (Exh. Staff-4, Sch. JAM-3), states that the submersible pump has "a capacity of 385 gallons per minute at 600 feet of TDH." (*Id.*)

Additionally, for adjustments related to the well, at a minimum, they should be limited to the incremental costs of the pump and motor that are over and above the costs that would have been experienced if "bare minimum" facilities had been installed. (Exh. LCSW-1, p. 13) Some type of pump and motor was absolutely required for the system no matter the number of customers actually connected.

Using Mr. Johansen's approach to capacity adjustment and a current number of customers of 72, results in the following changes to Staff's excess adjustment percentages: (1) For the adjustment related to the well, the adjustment would be reduced from 87% to 40%; (2) For the adjustment related to the water storage tank, the adjustment would be reduced from 70% to 65.71%; and, (3) For the adjustment related to the sewage treatment plant, the adjustment would be reduced from 77% to 65.71%. (Tr. 75; Exh. LCSW-1, p. 14)

This approach would still protect the customers in that they result in significant amounts of the current plant balances not being considered in the calculation of the Company's rate base for these cases (i.e. – being labeled as excess capacity). (Exh.

LCSW-1, p. 14) They would also be more fair and reasonable in regard to the investment that has been made in utility plant that is in service and used and useful.

6. Plant Held for Future Use

Should the capacity adjustment to rate base be recorded as plant held for future use?

In the Stipulation and Agreement in Company's certificate cases (Cases Nos. WA-2012-0018 and SA-2012-0019), plant in place, but deemed subject to Staff's capacity adjustment, was identified as "plant held for future use." Specifically, the Stipulation and Agreement stated as follows its Footnote 2:

> The Rockport water and sewer rate base numbers contemplate capacity adjustment [sic] that result in $153,160 of water plant and $98,410 of sewer plant being recorded as plant held in future use at a customer level of sixty-two (62) residential customers.

While Staff believes the parties are bound by this Stipulation and Agreement in other contexts (for example, the starting point for rate base), it appears to be less enamored with this specification that certain amounts be treated as plant held for future use.

To the extent the rate base starting points from the Stipulation are found to be controlling in this case (or future cases), the designation in that Stipulation of certain of the Company's plant as "plant held for future use," should also be controlling.

In addition to the designation of certain plant as "plant held for future use," LCSW takes the position that the balances identified as plant held for future use should have been removed from plant in service before the plant depreciation reserve calculation was done. (Exh. LCSW-1, p. 15) Failure to do so will result in a certain amount of plant being depreciated before the Company ever has an opportunity to earn either a return of or a return on that depreciated plant through growth in the customer base. (*Id.*)

While Staff alleges that this approach is contrary to the Uniform System of Accounts (USOA) (Tr. 191), the Commission has the authority to "to prescribe by order the accounts in which particular outlays and receipts shall be entered, charged or credited." (Section 393.140(8), RSMo) The Commission is, thus, not bound by the USOA and may reach a different result where doing so is reasonable and it so chooses.

As described above, under Staff's approach to excess capacity, the Company receives neither a return on, nor a return of (depreciation expense), on that portion of its investment deemed to be excess capacity. (Tr. 350-351) However, even though there is no recognition of the depreciation expense in the revenue requirement, Staff still accumulates depreciation reserve related to the excess capacity plant. (Tr. 351) Thus, Staff's approach guarantees that for some portion of the Company's investment, it will never recover a return on or a return of that investment. (Tr. 351-352, 355) No matter what the speed of growth, there is rate base and recovery of and on that rate base that is being permanently lost yesterday, today and tomorrow. (Tr. 352)

This Commission has previously recognized that an absence of rate base has negative impacts for small water and sewer utilities in regard to profitability, ability to finance repairs, ability to finance necessary construction and possible sale of the utility. Ultimately, lack of rate base many times backs a company into a receivership circumstance. Staff's approach to this excess capacity issue ignores these concerns related to small water and sewer company rate base.

The Commission should order that amounts deemed to be excess capacity be booked as "plant held for future use" and removed from plant in service before depreciation reserve calculations are done. This would be more consistent with Staff witness Merciel's stated purpose to allow "LCSW to recover additional capital expense as customer growth occurs and more capacity is utilized." (Exh. Staff-4, p. 16)

7. Depreciation Rates

a. What is the appropriate depreciation rate for the Company's submersible pumping equipment account on the Bennington system?
b. Should the Commission order adjustments to the accumulated depreciation for the Bennington submersible pump account?

LCSW supports Staff's depreciation rates and depreciation reserve calculation, other than the above issue associated with plant held for future use.

8. Rate Case Expense

What is the appropriate amount of rate case expense to include in the Company's rates?

LCSW filed this case as a small company rate case on December 4, 2012. (Exh. LCSW-3, p. 3) LCSW tried to process the case without hiring a lawyer. (Tr. 332) After the Company determined it would be unable to reach an agreement with Staff, it engaged the undersigned counsel[2] and a consultant, LCSW witness Dale Johansen, in an attempt to reach a result that recognizes the investment that has been made in these systems and the expenses and work that is required to provide water and sewer service to the LCSW customers. In Staff's initial audit (as well as in its direct testimony), Staff took a position that the full amount of the purchased and installed items should not be included in the Company's rate base. Only with the filing of rebuttal testimony did the

[2] Mr. Cooper filed an Entry of Appearance with the Commission on July 9, 2013.

Staff take a position in favor of including LCSW's meter investment in rate base. OPC continues to oppose.

These issues concern what is a substantial investment for LCSW with possible profound impact on the future of the Company. The Company is incurring rate case expense in order to bring the matters in dispute before the Commission. An allowance for this rate case expense should be included in the rate to be set in this proceeding utilizing no more than a three year amortization. (Exh. LCSW-1, p. 15-16). Staff has also normalized rate case expense over a three year period. (Exh. Staff-3, p. 12; Exh. Staff-8, p. 13) Public Counsel did not dispute the use of a three year amortization. (Exh. OPC-2, p. 32)

Further, the Commission should bring these expenses forward to a date that will allow the majority of costs to be captured in the Commission's order. Recently, the Commission recognized that many of a company's rate case expenses are not incurred until the hearing and will continue to accumulate even after the Commission issues its report and order. (*In the Matter of the Request for an Increase in Sewer Operating Revenues of Emerald Pointe Utility Company*, File No. SR-2013-0016 et. al, Revised Report and Order (September 24, 2013) ("Many of the company's rate case expenses were not incurred until the hearing and will continue to accumulate even after the Commission issues its report and order. It is appropriate to update rate case expenses through a date closer to when new rates will go into effect.")

In the *Emerald Pointe* case, the Commission used a cut-off date that was one week after the filing of post-hearing briefs. LCSW requests that a similar approach be used in this case, which would result in a cut-off date for rate case expenses of

November 29, 2013, based on the original due date for the brief, or December 3, 2013, now that the brief is due on November 26, 2013. (Tr. 194)

9. Certificate Case Expense

What is the appropriate amount of costs related the Company's certificate cases to include in the Company's rates?

To become a regulated water and sewer company, LCSW was required to apply for and obtain from the Commission certificates of convenience and necessity. This was accomplished in Commission Cases Nos. WA-2012-0018 and SA-2012-0019. This process necessarily included setting of initial water and sewer rates for the Company. This happens in every original certificate case. In fact, the Commission rules require an applicant for a water or sewer certificate of convenience and necessity to identify the "proposed rates and charges" as a part of the initial application. (*See* 4 CSR 240-3.305 and 4 CSR 240-3.600)

It is LCSW's position that these costs associated with the acquisition of the Commission certificates should be included as "Intangible Plant" in Account 302 – Franchises and Consents. (Exh. LCSW-2, p. 6) The Uniform System of Accounts (USOA) for small water and sewer utilities describes this account as follows (emphasis added):

> A. This account shall include amounts paid to the federal government, *to a state* or to a political subdivision thereof *in consideration for* franchises, consents, or *certificates . . . together with necessary and reasonable expenses incident to procuring such . . . certificates of permission and approval* . . ."

The certificate case expenses amount to $4,810.[3] (Tr. 198) These expenses were necessary and reasonable expenses incident to procuring the certificates of convenience and necessity that provide the basis for LCSW's activities as a regulated entity. The amount identified by the Company does not include any costs associated with past complaint cases. (Tr. 196)

Staff and the Public Counsel argue for a different result by suggesting that the expenses are something akin to "rate case expenses." This is a silly argument, as initial rates are *always* set in a certificate case and such cases often involve an audit being conducted. (Exh. LCSW-2, p. 6; Tr. 198, 259)

Public Counsel further suggests that somehow these costs were included in the rates set in the Company's certificate cases. (Exh. OPC-2, p. 18) A review of the Stipulation and Agreement shows no identification of certificate case expenses. (Tr. 241) While rates were agreed to, what was, or was not, included in those rates was in the eye of each party. Any allegation that a certain cost was contained in the "Staff's workpapers," at best represents Staff's viewpoint (Tr. 241-242) and not that of LCSW or the Commission.

The costs at issue are simply not "rate case expenses." (Exh. LCSW-2, p. 6) They are costs related to LCSW obtaining required certificates of convenience and necessity from the Commission, and the fact that rates were set in the certificate cases is normal. (*Id.*) Further, the costs at issue are not "transition costs" of the type suggested by Public Counsel witness Mr. Addo in that LCSW did not operate the subject systems prior to July of 2012. (*Id.*) Finally, even if the costs were transition

[3] In spite of Public Counsel's suggestion that it had not seen this number prior to the hearing (Tr. 258), it is referenced in the Rebuttal Testimony of Public Counsel witness Addo (Exh. OPC-2, p. 18).

costs, a fair reading of the applicable USOA account descriptions leads to the conclusion that the costs are organization costs that should be recorded in Account 302.

10. Office Rent/Office Utilities

What is the appropriate amount of expense to include in rates for the Company's office space, including rent and utilities?

The Company has dedicated office space for LCSW in order to separate its utility operations from other businesses. (Exh. LCSW-1, p. 3) The actual rent of $950 per month, and the utilities in the amount of $85 per month for electric and $65 per month for water should be used in determining the Company's cost of service. (*Id.*; Tr. 199) While Staff and Public Counsel make allegations about other potential costs and the "triple-net" nature of the lease, no other rate recovery is being requested by LCSW related to its office space. (Tr. 201) Thus, other types of "potential" expenses that may be identified by Staff or Public Counsel are irrelevant to this issue.

The office is conveniently located conveniently close to one of the subdivisions served by LCSW (Bennington) (Exh. LCSW-6; Exh. LCSW-4, p. 5; Tr. 243) It is laid out in a way that allows visitors to easily enter and exit the parking lot and offices. (Exh. LCSW-4, p. 5) A location for a payment drop box is also available at the office. (*Id.*) One Company receives approximately one-third of its monthly payments through the drop box. (Id.)

The office space is built on a crawl space and has no basement. (Exh. LCSW-4, p. 2) A diagram of the available space is found at page 3 of Mr. Kallash's Surrebuttal Testimony. (Exh. LCSW-4)

The space has a reception area located immediately adjacent to the front door. (Exh. LCSW-4, p. 3-4) It has a couch, table and chair. (*Id.*) A room to the left of the front door is used for the display of plat maps and utility maps associated with the utility's certificated territory; a six foot table; all the work orders associated with inspection, shut offs and closing dates; and, the storage of meters. (*Id.*) An additional 11' x 11' room contains the telephone and 1 answering machine for the utility and is used to provide space for private appointments with customers and completion of application for service, as it is the only room (other than the bathroom and furnace room) that has a door and can be closed. (*Id.*) This room contains a table and a couple of chairs to be used in the referenced meetings. (*Id.*)

The space is owned by the Kallash Revocable Intervivos Trust. (Exh. LCSW-4, p. 5) However, in 2009, Mr. Kallash executed a Contract for Deed with Mike Lordo. (*Id.*) That Contract for Deed granted Mr. Lordo possession of the real estate along with other indices of property ownership. (*Id.*) The lease LCSW currently has on the property was negotiated with Mr. Lordo. (*Id.*) While Mr. Lordo may be an acquaintance of Mr. Kallash, he does not represent an affiliate of either Mr. Kallash or LCSW. (Tr. 303) Mr. Kallash is not involved in any other business activities with Mr. Lordo. (Tr. 320) Even if he were, the Commission has no affiliate transaction rules that apply to water and sewer companies (Tr. 303) and the Financial Accounting Standards Board citations provided by Staff witness Boateng have no applicability to LCSW as it is not regulated by the Securities and Exchange Commission. (Tr. 303-304)

The monthly rental paid by LCSW is reasonable. (Tr. 323) Previously, when Mr. Kallash had control over this property, the property was rented to a third party business (a hairdresser/salon) for $1,200.00 per month. (Exh. LCSW-4, p. 6) The $950 per month reflected in the current lease was, and is, a discount from that established market value of the property. (*Id.*)

Staff witness Ferguson suggests that it may have been appropriate for the Kallash's to instead operate this utility out of their home. (Exh. Staff-3, p. 6) That is not an option for LCSW. The Company has many customers that prefer to drop off, rather than mail, their payments. (Exh. LCSW-4, p. 6) LCSW also has customers that come to the office to initiate service, fill out applications and discuss questions about billing and other matters. (*Id.*; Tr. 319-320) These are activities that would not be appropriate to be conducted from one's home. (*Id.*) Such visits would also be made very difficult by the location of the Kallash's home as they live far out in the country and have a mile long drive-way to the house. (*Id.*) That drive-way includes a bridge, which is about 10 feet above a creek, and has no railings. (*Id.*) This is not an appropriate location for conducting utility business. (*Id.*)

The amounts for office space proposed by the Staff and Public Counsel are purely hypothetical. Similar space may or may not be available in the area of the Bennington and Rockport subdivisions at the prices quoted by Staff and Public Counsel.

Staff witness Ferguson states that she believes that there was a 200 square foot office space available in Troy for $500 a month, plus $75 in utilities. (Exh. Staff-3, p. 7). Mr. Kallash was not familiar with any such property being available at the time LCSW leased the office property. (Exh. LCSW-4, p. 7) However, even if it were, a review of Exh. LCSW-6 reveals that property within the city limits of Troy would not be convenient for residents of either subdivision served by LCSW. Additionally, Ms. Ferguson describes her space as a unit among four office units that shared certain facilities. (Exh.

Staff-3, p. 7) It is doubtful that any such unit would provide the space for a convenient drop box location, parking and ease of access for customers that are present at the current location. (Exh. LCSW-4, p. 7)

Public Counsel witness Addo took a different approach. He suggested, without reference to property size, that a review of Troy rentals "revealed an average rental rate of 78¢ per square foot per month." (Exh. OPC-2, p. 5) This information is of little to no value without a comparison size and condition of the spaces. (Exh. LCSW-4, p. 7-8) Generally, per square foot rents will be greater for smaller areas being leased. (*Id.*) In fact, this can be seen from Mr. Addo's own testimony. He indicates that the Company's office is being rented for an equivalent of $1.46, per square foot per month, and that the Staff's suggestion of a 200 square foot space would rent for $2.50 per square foot per month. (*Id.*) The Company's office, while larger, is actually cheaper per square foot. (Id.) Mr. Addo's 78¢ per square foot would only be achievable if one were renting a much, much larger space than the Company's office, which would also result in a much higher monthly rent amount than what LCSW is currently paying. (Id.)

Mr. Addo's recommendation is further suspect in that he did not do any comparison as to where other properties were located or whether they were close to the subdivisions served by LCSW. (Tr. 245) However, his properties were only within the city of Troy. (Tr. 246)

The size, location, available parking and the opportunity to maintain a drop box for customer payments, all make the current office space an appropriate space for LCSW's operations. The rent of $950/month, as well as the actual utility expenses of

$85/month for electric and $65/month for water – should be included in LCSW's cost of service.

11. Property/Liability Insurance

What is the appropriate amount of expense to include in rates for property or liability insurance?

LCSW indicated at hearing that it was no longer pursuing this issue. (Tr. 46) LCSW accepts the amount for this expense contained in the Staff accounting schedules dated October 31, 2013. (Exh. 11)

12. Income Taxes

Is it appropriate to include income tax expense in the Company's cost of service?

The Staff does not include consideration of income tax expense in the calculation of its revenue requirement because LCSW is a limited liability company and has no direct tax liability. (Exh. Staff-3, p. 25). In support of Staff's position, Staff witness Ferguson states that "any profit or loss of the Company is recorded on the owner's (Mr. Kallash's) personal tax return and will be offset by the tax results for other businesses owned by Mr. Kallash that may be recorded on the personal tax return." (*Id.* at p. 24; Tr. 267) This is a "distinction without a difference."

While LCSW does not file its own income tax return, income tax associated with its utility operations is still incurred by the Company's members. (Exh. LCSW-4, p. 13; Tr. 267) The Company's gains are flowed through to the members individual tax returns where they are taxed at an individual rate. (*Id.*) We should assume for purposes of this issue that there will be gain, because as Staff witness Ferguson acknowledged, Staff would not recommend a revenue requirement for a utility that it thought would result in a loss for that utility. (Tr. 267) In fact, the objective of this case is to produce a rate that will result in a gain for LCSW and its members. (Tr. 204-205) Such gains create an income tax liability for the members. (Tr. 267-268)

A different approach is taken where a corporate utility files a consolidated tax return with its parent and thereby allows its income to be potentially offset by the tax results for other subsidiaries owned by that parent. An example of this is found in the following passage from the Commission's Report and Order in *In the Matter of St. Louis Water Company*, 23 Mo. P.S.C. (N.S.) 63, 69 (1979):

> For the test year ending June 30, 1978, adjusted for known and measurable changes through December 31, 1978, Staff found the allowable income tax figure for ratemaking purposes of Company should be $1,148,274. The Company concurred with this figure. This tax figure is arrived at by using a 46 percent effective tax rate for the Company. Computing taxes in this manner represents the traditional method of computing income tax expense for ratemaking purposes, based on the financial status of the Company.
>
> The Public Counsel contends that this may represent the amount of taxes Company would be required to pay if it paid taxes direct to the State and Federal Governments, but this Company files a consolidated tax return with its parent, Continental Water Company, (Continental). Company is one of five subsidiaries owned by Continental. By filing a consolidated return, Continental is alleged to achieve a lower effective tax rate and Public Counsel contends this tax rate should be used in computing Company's allowable taxes for ratemaking purposes.
>
> Although in the past the Commission has refused to accept positions similar to that taken by Public Counsel herein, we do not believe that we need reach a conclusion on the merits of that position in this case.

It is LCSW's position that the Commission should not treat LCSW differently than other PSC-regulated corporations in regard to income taxes simply because the tax liability accrues to the members personally as opposed to a corporation. (Exh. LCSW-1, p. 19) In the consolidated tax structure described above, the regulated entity would not file a separate tax return. Its income would instead be reflected on the tax return of its owner (or "parent") to be potentially offset by the tax results for the owner's (parent's) other businesses. There is no real difference other than the small operating company that finds it more efficient and economical for its customers to use a limited liability company is provided no recognition of the income taxes associated with its operations.

Staff witness Ferguson sees the Staff position as a consequence of "the Company's managerial decision." (Exh. Staff-3, p. 25) However, the Staff approach provides an incentive for small companies to operate in a less efficient manner. (Exh. LCSW-4, p. 14) While LCSW's current structure minimizes the taxes associated with LCSW's operations, the Company would be benefited financially (at the expense of its customers), if it became a general business corporation, paid taxes and treated the members as employees. (*Id.*)

A better public policy would be to utilize an income tax calculation for LCSW that differs from the corporate income tax calculation used by the Commission only in the tax rate utilized. (Exh. LCSW-1, p. 19) Income taxes should be computed at a rate of at least 16% (a combination of the minimum Federal (10%) and State (6%) individual income tax rates). (Exh. LCSW-2, p. 17) To effectuate the provision of such income taxes, the Commission should order that the Company's equity return be grossed up to account for these taxes. (*See* Tr. 268)

Ignoring income tax expense serves to punish the Company's members for utilizing a corporate structure that is advantageous to its customers and ensures that the Company will not have a reasonable opportunity to earn a fair return on its investment.

13. **Salaries – Dennis and Toni Kallash**
    a. What is the appropriate level of salary to include in rates for Dennis Kallash?
    b. What is the appropriate level of salary to include in rates for Toni Kallash?

a. Dennis Kallash

The Company believes Mr. Kallash should be paid based upon the time he spends working for the utility company and that he should be compensated at a reasonable hourly rate. In contrast, the Staff has simply continued an annual "management fee" of $7,500 it used in the estimated cost-of-service calculation in the Company's certificate cases. This is a ridiculously low figure in relation to the tasks performed by Mr. Kallash to keep these systems operating dependably on a day to day basis. Moreover, the Commission's own rules require, in regard to sewer plant, "inspections of all mechanical equipment on a daily basis." 4 CSR 240-60.020(8).

This Staff management fee equates to a figure of *$5.13*, per system, per day ($7,500 ÷ 4 systems ÷ 365 days). Such a figure would not come close to adequately addressing the time and care Mr. Kallash puts into the maintenance and operation of these systems.

Description of Work Performed

Mr. Kallash performs many functions for the utility on a daily and monthly basis to include items such as responding to service-related customer calls, performing the required water sampling, performing inspections of new customer connections, monitoring the operation of the sewer and water systems, reading the water meters, ordering field supplies, installing water meters, and being the Company's contact person for dealings with the Commission and the Department of Natural Resources. (Exh.

LCSW-4, p. 9-10) He also checks the wells and record master meter readings; negotiates contracts and meets with contractors; spot checks the condition of meters and meter pits; periodically checks the operation of the sewage treatment plants; prepares the handheld meter reading device for meter readings; reviews monthly reports produced by the billing program, with particular attention paid to meter exception reports; contacts customers if the billing program reports indicate unusual usage patterns; handles sewage treatment plant problems due to electric service outages; sprays water and sewer facility grounds for weed/grass control; assists the contract operator on plant repairs; cleans the sewage treatment plant clarifiers as requested by the contract operator; participates in weekly phone conferences with the contract operator and monthly meetings with the contract operator; submits monitoring and sampling reports to the DNR; and accompanies Commission and DNR personnel on system inspections. (*Id.*)

Mr. Kallash has performed activities for utility systems for 16 years. (Exh. LCSW-1, p. 11)

Hours and Pay Rate

LCSW witness Johansen has included 57 hours a month in his calculations, or 684 hours a year (not including water testing time). (Exh. LCSW-1, p. 11)

Staff seems to fall back on its $7,500 because the auditors are dissatisfied with the documentation kept by Mr. Kallash. However, Mr. Kallash does keep records. He maintained a spiral notebook in which he recorded notes of his activities, along with times and mileage, for those tasks beyond the regular operation checks and visits he has to make to the water and sewer systems. (Exh. LCSW-4, p. 11) His hours are also supported by the well log records that reflect his visits. (Exh. LCSW-4, p. 15)[4]

Mr. Johansen's proposed 57 hours/month is a minimum amount of time Mr. Kallash will spend on LCSW activities in a month. (Exh. LCSW-4, p. 12) It is almost always greater than this (*Id.*), as the hours used by Mr. Johansen can be supported by merely reviewing the standard and reoccurring activities performed by Mr. Kallash.

Mr. Kallash, for example, checks the well pumps and records readings from 13-15 times a month. (*Id.*) Each of these trips is a 20 mile round trip and takes an hour and a half. (*Id.*) He also inspects and performs maintenance at the sewer treatment plants every other day. (*Id.*; Tr. 330) This is also a 20 mile round trip and takes approximately two and one-half hours. (Exh. LCSW-4, p. 12)

Just completing these operations duties as performed by Mr. Kallash takes 57 hours per month before meter reading, billing, inspection of connections and the many other tasks must be performed. (*Id.*) Thus, Mr. Kallash's Company activities take a minimum of 684 hours annually (57 hours/month) (not including water testing time).

Mr. Johansen used the "MERIC" or Missouri Economic Research and Information Center wage data produced by the Missouri Department of Economic Development to determine an appropriate hourly rate. (Tr. 249) Based on the applicable regional wage information from 2012 for experienced "general and operations managers", and the CPI-W data for June 2013, the Company believes an hourly pay rate of $39.65 for Mr. Kallash is appropriate. (Exh. LCSW-1, p. 11)

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[4] Record keeping has been a point of frustration for Mr. Kallash in that he has had Auditing section staff tell him his methods were not sufficient, while Water & Sewer Department staff have indicated the same methods are fine. (Exh. LCSW-4, p. 11)

The Company also believes Mr. Kallash's pay rate should be further adjusted to include the payroll taxes the Company would be paying if he was paid as an employee, which would result in an hourly pay rate of $42.68/hour. (*Id.*) Mr. Kallash may not be an employee of the Company, because he is a member/owner. However, these dollars will be subject to self-employment, as well as flow through to his tax return where they will be subject to income tax. (Exh. LCSW-4, p. 13) Adding the payroll tax amount will partially offset the taxes that will be paid.

OPC witness Addo suggested that the wage rate used by the Company is "excessive and lacks support." (Exh. OPC-2, p. 27) However, during cross-examination he admitted that he had reviewed the MERIC wage data used by Mr. Johansen. (Tr. 249-250) It just had nothing to do with Mr. Addo's analysis, so he deemed it to not be support. (Tr. 250) This is even though Mr. Addo uses the MERIC data in his analysis with other companies. (Tr. 251)

He also did not bother to compare the hourly wage identified by Mr. Johansen with the wages paid to the Commission's receivers. (*Id.*) It certainly seems like this would have provided a little context for Mr. Addo's analysis before he tried to identify the amount as "excessive."

Mr. Kallash should be fairly compensated for the time it takes to run these water and sewer systems. In analyzing the costs identified, it is important to remember that there are four systems (two water and two sewer). The salary identified is the total of what would be spread amongst the four systems. If Mr. Kallash were to instead hire a contract operator, it would cost a more. (Tr. 330) Mr. Kallash should receive reasonable compensation for the necessary and very real work he must do to keep these systems operating in a safe and adequate manner.

b. Toni Kallash

The Company believes the Staff's annualization of Ms. Kallash's work hours understates the hours she works because it includes two months that are not reflective of the time that Ms. Kallash spends on utility-related work. LCSW also believes that the Staff pay rate is understated because it does not recognize the 16 years of experience that Ms. Kallash has in utility work.

Description of Work Performed

Ms. Kallash performs many functions for the utility on a daily and monthly basis to include items such as producing customer bills, picking up and depositing customer payments, answering customer calls, monitoring the Company's answering machine, meeting with new applicants, general bookkeeping, purchasing office supplies and dealing with title companies on property transfers. (Exh. LCSW-4, p. 10-11) She also responds to customer inquiries regarding billings; posts accounts receivable; monitors accounts payable; prepares the billing program for meter readings reviews monthly reports produced by the billing program, with particular attention paid to meter exception reports; reads meters; prepares documents for tax accountant; and prepares the sales tax report for the Missouri Department of Revenue. (*Id.*)

Ms. Kallash has performed these functions for utility operations for approximately 16 years. (Exh. LCSW-1, p. 9)

Hours and Pay Rate

The Company believes the Staff's annualization of Ms. Kallash's work hours understates the hours she works because it includes two months that are clearly not reflective of the time that Ms. Kallash spends on utility-related work. (Exh. LCSW-1, p. 9) The Company takes the position that a monthly average of 87 hours should be used in lieu of the Staff's monthly average of 66 hours. (*Id.*) These hours do not include consideration of the hours that would be necessary, in the absence of the billing program discussed in Issue 2 above. (*Id.*)

LCSW agrees with the three job positions the Staff used in its wage analysis for Ms. Kallash. However, LCSW does not believe that the Staff took into account the 16 years of experience Ms. Kallash has with utilities.

Based on a review of the applicable regional wage information (the "MERIC" or Missouri Economic Research and Information Center information produced by the Missouri Department of Economic Development) from 2012 for an *experienced* employee in the three job positions the Staff used in its analysis and the CPI-W data for June 2013, the Company believes an hourly pay rate of $15.34 for Ms. Kallash is appropriate. (Exh. LCSW-1, p. 10; Exh. LCSW-2, p. 8)

The Company also believes Ms. Kallash's pay rate should be further adjusted to include the payroll taxes the Company would be paying if she was paid as a direct employee, which would result in an hourly pay rate of $16.51/hour. (*Id.*) Ms. Kallash may not be an employee of the Company, because she is a member/owner. However, these dollars will be subject to self-employment, as well as flow through to her tax return where they will be subject to income tax. (Exh. LCSW-4, p. 13) Adding the payroll tax amount to the hourly rate will partially offset the taxes that will be paid.

14. Mileage

What is the appropriate amount of expense to include in rates for vehicle mileage?

LCSW does not own any vehicles, which saves the customers money. Thus, the question for purposes of the revenue requirement is what amount of expense to add based on the mileage Mr. and Ms. Kallash use other vehicles to do LCSW business.

Company witness Johansen has calculated that the Company is incurring expense related to vehicle mileage on an annual basis in the amount of $2,572, for Mr. Kallash, and $504, for Ms. Kallash. (Exh. LCSW-2, p. 14) Staff used $1,433 and $81 for these expenses, respectively. (*Id.*)

There were complaints from Staff and Public Counsel as to the information provided in regard to the Company's vehicle mileage. However, Mr. Johansen opined that "there is more than sufficient information available to support the mileage expenses." (Exh. LCSW-2, p. 13) While not in the format the Staff witness would prefer, Mr. Kallash keeps records for vehicle use associated with LCSW activities. He uses a notebook for special trips (Exh. LCSW-4, p. 15; *See*, for example, Exh. LCSW-4, Sch. DK-4S) combined with records found in the well logs for this purpose. (Exh. LCSW-4, p. 15) For the trips represented by the well logs, there is a consistent and never-changing distance that can be applied to derive mileage. (Exh. LCSW-4, p. 15) Mr. Johansen used these records to calculate his proposed vehicle expense. (Exh. LCSW-4, p. 15)

For Mr. Kallash's annual mileage expense, the Staff assumes an average of 12 monthly master meter reading trips for the Bennington system and an average of 9 monthly master meter readings for the Rockport system, during which it is assumed the customer meters will be read. (Exh. LCSW-1, p. 16-17) However, the Staff does not include any "miscellaneous" trips to the systems for purposes such as customer trouble calls or service installation inspections. (*Id.*) This low number of trips utilized by the Staff is greatly deficient in relation to its own rules, which, in regard to sewer plant, require "inspections of all mechanical equipment on a daily basis." 4 CSR 240-60.020(8).

Based on its current practices, the Company believes that an average of 14 monthly master meter reading trips, during which customer meters would be read, and four "miscellaneous" monthly trips per system (2 per service) would be much more reasonable to calculate Mr. Kallash's annual mileage expense. (*Id.*) For the miles per trip, the Company agrees with the mileage used by the Staff. (*Id.*)

For Ms. Kallash's annual mileage expense, the Staff uses 144 trips and 1 mile per trip in calculating its allowed expense. (Exh. LCSW-1, p. 16) The Company agrees with the number of trips the Staff used (an average of 12 "bank trips" per month to deposit customer payments); however, the round-trip mileage from the Company's office to the bank is 6.2 miles. (*Id.*) At the appropriate distance of 6.2 miles, Staff's mileage figure for Ms. Kallash is the equivalent of about two bank trips a month ($81 per year ÷ $0.56 per mile ÷ 6.2 miles = 23.33 trips per year). That is considerably fewer than the 144 bank trips the Staff calculation would imply is appropriate.

15. Testing

What is the appropriate amount of expense to include in rates for water testing?

Staff recommends the addition to the Company’s revenue requirement of $360 on an annual basis. (Exh. LCSW-2, p. 14-15) This equates to $180 per system, per year ($360 ÷ 2 water systems). Tests must be conducted a minimum of once a month, and usually more tests are required. This means that the Staff figure is, *at most*, $15 per test. For comparison, when Mr. Kallash used a third party to perform the water testing, he was charged $150, per month, per subdivision. (Tr. 173)

LCSW asserts that Staff’s water testing expense should be increased by $1,504 on an annual basis in order to address the expenses specifically associated with the water testing required by the Department of Natural Resources and performed by LCSW. (*Id.*) This result in approximately half the cost of Mr. Kallash was charged by the third party tester.

The Company's adjustment is based on the incremental time and mileage expenses (i.e. not included in recommended expense amounts for labor or mileage) related to the testing trips the Company makes to the systems and the Company's estimate of the supplies used to perform the required system tests. (Exh. LCSW-2, p. 15) The Company’s calculation considers the fact that there 20 testing trips required, and that the per trips costs are as follows: incremental mileage of 5 miles/trip above the mileage accounted for elsewhere; incremental time of 2 hours/trip above the work hours accounted for elsewhere; and miscellaneous supplies at $5/trip. (Exh. LCSW-1, p. 17) A spreadsheet specifying the elements of Company’s adjustment is found in the

Surrebuttal Testimony of Mr. Johansen, at Schedule DWJ-3S. (Exh. LCSW-2, Sch. DWJ-3S)

Mr. Johansen is personally familiar with what is involved in water testing. (Tr. 206) He utilized that experience in coming up with the time and expenses he identifies as support for his adjustment. (Tr. 207) Mr. Johansen took into account the time it takes to prepare the site, to take the sample, to prepare the paperwork associated with the sample, and then to deliver the sample to either a lab or to a health department office. (Tr. 207-208) This experience (along with conversations with Mr. Kallash) was further useful in identifying the supplies that are necessary to perform this function. (Tr. 208) In contrast, neither the Staff nor the Public Counsel witness identified any experience with water testing that would be helpful in determining a reasonable amount of time or supplies associated with this function.

The water testing cost identified by LCSW is reasonable in comparison to third party charges and supported by the expert testimony of Mr. Johansen, an experienced operator of small utilities, with personal experience with the testing of water. In contrast, the Staff's suggested amount is ridiculously low on the face of it and has absolutely no relation to reality.

16. Sludge Hauling

What is the appropriate amount of expense to include in rates for sludge hauling?

The sludge hauling issue concerns two elements. First, what amount should be added for hauling sludge from the sewage treatment plants to an off-sight location for land application. Second, what amount should be added for partial pumping of the sewage treatment plant clarifiers.

The Company believes this expense should be set based on the gallons hauled and cost for hauling for the most recent year that hauling information is available for each system (2012 for Bennington and 2011 for Rockport). (Exh. LCSW-1, p. 12) This would result in the use of $4,005, for hauling sludge. (Tr. 209) This is an increase of $1,225 over the amount proposed by Staff ($2,780) (*Id.*) Additionally, approximately $200 per month (or, more precisely, $4,895) should be added for the pumping of the sewage treatment plant clarifiers. (Exh. LCSW-1, p. 12; Tr. 209)

The charge for sludge hauling is $0.14 per gallon pumped from the clarifiers. (Exh. LCSW-4, p. 14) At the time this rate was chosen, the lowest rate Mr. Kallash could find was $0.15 per gallon pumped. (*Id.* at p. 15) Since then, third party rates have risen to $0.17 per gallon pumped, while rate used for LCSW has remained the same. (*Id.*)

Staff uses a three year average of sludge hauling expenses to compute this expense. (Exh. LCSW-1, p. 11) This method of calculation does not provide a reliable estimate as to what the costs will be for LCSW during the period of time the rates set in this proceeding will be in effect.

LCSW's certified treatment plant operator has recommended that LCSW:

> . . . pump sludge holding once per quarter at the Bennington WWTP and Rockport WWTP also if you could remove any solids buildup from the clarifier stilling well each month with the pump truck would help to insure the following:
>
> 1. Reduced loading on the treatment plant from filtrate return from sludge holding which has high Ammonia and BOD concentrations
>
> 2. Insure more usable volume in sludge holding also this should help reduce odor.

> 3. Allow flexibility for land application during varying weather conditions so we don't create an "**<u>Emergency situation</u>**"
>
> I understand this may seem excessive to some but sludge management is the most cost effective tool in maintaining these facilities, with the new ammonia regulations and the possibility stricter ammonia limits and new phosphorus limits; poor planning or being frugal in this area in my opinion is a potential recipe for disaster.

(Exh. LCSW-2, Sch. DWJ-2S)

LCSW is operating consistent with the recommendation of its sewage treatment plant operator and has implemented a program to haul sludge from its treatment plant on a quarterly basis and pump its clarifiers on a monthly basis. (Exh. LCSW-1, p. 12; Exh. LCSW-2, p. 10) As a result, the most recent annual sludge hauling costs are more reflective of the Company's costs going forward. (Exh. LCSW-2, p. 10)

Using the Staff's average ignores the way sludge hauling is currently performed and clarifier pumping is accomplished. Additionally, for the Rockport system, the Staff's average includes one year for which the Company had no hauling expense because the Company was able to use a part of its sewage treatment plant for sludge holding. (Exh. LCSW-1, p. 11-12; Tr. 210) This aspect of the Staff average just adds "insult to injury" as the treatment storage used to avoid this cost for a time is a part of the treatment plant for which Staff provides the Company no return on, or of, its investment as a result of Staff's "capacity adjustment."

17. Office Supplies and Postage (Mailing of Consumer Confidence Report)

What is the appropriate amount of expense to include in rates for office supplies and postage in regard to the mailing of the Consumer Confidence Report?

Staff fails to include the cost of mailing incurred by LCSW to provide the Department of Natural Resources (DNR) annual consumer confidence report to its customers. (Exh. LCSW-1, p. 18) The report is required to be produced by DNR regulation and notice of the report must be provided to the Company's water customers within a specific time frame. (Tr. 211, 212) While LCSW meets these obligations by direct mailing this report to its customers (Exh. LCSW-4, p. 16; Tr. 213), Staff essentially argues that LCSW should conduct its business differently and mail the report along with its monthly bills. (Exh. Staff-3, p. 27-28)

LCSW has difficulty mailing the report in its regular billing envelope and the report is not always received from DNR in conjunction with the Company's billing cycle. (Exh. LCSW-4, p. 16) Separate mailing allows the Company to get this information to its customers as soon as possible and to do so within the time suggested by DNR. (Exh. LCSW-4, p. 16-17) Moreover, the customers benefit from the direct mailing of this report, as they are not likely to see it, if it is sitting on a desk in the company's offices. (Tr. 213)

The Company's cost of service should include the costs associated with this separate mailing ($217 - $56 for supplies and $161 for postage). (Exh. LCSW-1, p. 18) *It is ridiculous that the Company is required to take this issue to hearing in an attempt to get recognition of an expense directly related to the provision of good customer service*.

18. Late Fees

What is the appropriate amount of revenue to include in rates for late fees?

This is a "revenue" issue. In other words, the question is how much of the ultimate revenue requirement should be assumed to come from the collection of late fees, rather than the customer charges or volumetric charges paid by customers on a monthly basis. (*See* Tr. 219-220) If a greater amount is assumed than is actually experience, the Company will not have a reasonable opportunity to earn its allowed return, or to cover its costs.

Based on known changes in specific customers, Staff's miscellaneous revenues related to late fees is overstated by 11 accounts for Rockport and by 3 accounts for Bennington. (Exh. LCSW-1, p. 16) This represents about $2,100 in assumed revenue in the Staff case. (Tr. 219) Staff's proposed late fees are not broken down by account. (*Id.*) For this reason, LCSW witness Johansen was unable to propose an adjustment related to the now absence of chronic late payers.

19. Telephone and Internet

What is the appropriate amount of expense to include in rates for telephone and internet usage?

The *actual* monthly amount that the Company pays to CenturyLink for its telephone/internet landline "bundle" for the telephone at its utility office (and related monthly charges, fees, surcharges and taxes) should be used in determining its cost of service. (Exh. LCSC-2, p. 16) The net cost of the telephone/internet landline bundle is $95/month and the related monthly charges, surcharges, taxes and fees are $33.65/month. (*Id.*) LCSW believes that this is the "basic package" provided by CenturyLink – the "least expensive" package that was available to it. (Tr. 221-222)

Public Counsel suggests that the Company provided no support as to how it "determined the $95 monthly cost." (Exh. OPC-2, p. 37) There is no mystery. A copy of an actual CenturyLink bill that shows the origin of this amount, as well as what services are included in the package, is provided as Schedule DWJ-5S. (Exh. LCSW-2, Sch. DWJ-5S) The "Preferred Customer Discounts" in the amount of $40 are subtracted from the "Core Connect Business Primary Line Bundle" charge of $135. (*Id.*)

Staff witness Boateng, of course, was not present when LCSW inquired of CenturyLink as to available services or contracted for the subject service. (Tr. 312) Staff's initial position is essentially that while LCSW is paying the amounts LCSW seeks to include in the revenue requirement, Staff would have made a different managerial decision.

The Commission should allow LCSW to recover the *actual* monthly amount that the Company pays to CenturyLink for its telephone/internet landline "bundle" for the telephone at its utility office.

20. Electricity Expense (Operations)

What is the appropriate amount of expense to include in rates for electricity related to the Rockport well and sewage treatment plant?

LCSW indicated at hearing that it was no longer pursuing this issue. (Tr. 312) LCSW accepts the amount for this expense contained in the Staff accounting schedules dated October 31, 2013. (Exh. 11)

21. EMSU Staff Recommendations

Should the Company continue to implement the recommendations of Staff's EMSU unit regarding time sheets, vehicle logs, estimation procedures, after-hours availability, and distribution of customer rights information?

LCSW has agreed to most of these items previously in the Cases Nos. WA-2012-0018 and SA-2012-0019 Stipulation (*See* paragraphs 14, 15, and 19), implemented the recommendations of Staff's EMSU unit and will agree to continue to comply with those recommendations and work with Staff in the future as to these issues. (Exh. LCSW-4, p. 17-18).

WHEREFORE, LCSW respectfully requests that the Commission consider this

Brief.

Respectfully submitted,

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Certificate of Service

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 26th day of November, 2013, to:

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