

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

In the Matter of Lake Region Water & Sewer )  
Company's Application to Implement a General ) **File No. WR-2013-0461, et. al**  
Rate Increase in Water and Sewer Service )

## **STAFF'S RESPONSE TO APPLICATIONS FOR REHEARING**

**COMES NOW** the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Response to Applications for Rehearing*, states:

***Office of the Public Counsel:***

1. In its *Application for Rehearing*, the Office of Public Counsel (OPC or Public Counsel) alleges three issues on which the Commission's *Report and Order* in this matter is unlawful, unjust and unreasonable. These issues are: 1) the failure to apply availability fees against rate base, 2) the inclusion of a return on equity (ROE) of 11.93%, and 3) the inclusion of breach of contract legal fees in rates. Public Counsel alleges the Commission misapplies the burden of proof on each of these issues.<sup>1</sup> Staff will respond generally to each issue raised.

**A. Failure to apply availability fees against rate base:**

2. Although Staff argued a different position than Public Counsel, it agrees the burden of proof to show that a rate increase is just and reasonable rests with Lake Region Water & Sewer Company (Lake Region).<sup>2</sup>

3. When Lake Region filed its application to increase gross annual revenues on July 15, 2013, the Commission's Staff conducted a review of all cost of service components to enable it to make a recommendation on whether the requested rate

<sup>1</sup> OPC Application for Rehearing, pp. 2, 5,

<sup>2</sup> §393.150.2 RSMo.

increase was just and reasonable. As a part of the audit process, Staff evaluates the Company's revenues to determine the amount of revenue deficiency projected to occur in the test year. The revenue deficiency is the difference between expected revenues and the calculated revenue requirement and represents the amount of revenue increase, if any, the utility needs to cover the cost of providing service.

4. Staff included revenue derived from availability fees in its calculation of the overall revenue for Lake Region, causing a decrease in the projected revenue deficiency and ultimately a recommendation for a lower rate increase than Lake Region initially requested.<sup>3</sup> Staff's audit and filing of its direct case on revenue requirement is a normally occurring and necessary step in any rate case. By pointing out that Lake Region had failed to disclose a revenue stream that it should have included in its case, Staff was not raising an affirmative defense.<sup>4</sup> Staff was, instead, performing its duty of advising the Commission of relevant factors for consideration. Consequently, Staff believes that the Commission misapplied the burden of proof in the Availability Fees section of its *Report and Order*. The burden was *not* on Staff and OPC to show that the availability fees revenue should be included, but rather on Lake Region to show that it should not.

For example, on p. 42, the Commission stated,

There is an indication that Lake Region's predecessor may have received availability fees in 1992, but Staff and Public Counsel did not explore this further or present any evidence on this point. Staff alleges that the assignment of the availability fee revenue to the Lake Region shareholders was imprudent, but presented no evidence about the specific

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<sup>3</sup> Staff's Exhibit 1, Staff's Cost of Service Report.

<sup>4</sup> A better analogy is to an income tax audit in which Lake Region, as the taxpayer, is attempting to persuade the taxing authority that the availability fees revenue stream is not subject to tax. Certainly the burden of proof and the risk of non-persuasion in such a case is squarely on the taxpayer.

details of the assignment, the reasons for or against that action, why the assignment was improper, or how it resulted in harm to the ratepayers. \* \* \* The Commission concludes that Staff has not presented sufficient evidence to show that Lake Region or its predecessor imprudently assigned the availability fees to its shareholders in 1998 or used that revenue for utility purposes, thus making the fees a part of Lake Region's "franchise, works or system" at the time of the fee assignment.<sup>5</sup>

In this paragraph, the Commission repeatedly misapplied the burden of proof against Staff and OPC, specifically stating that gaps in the record were their responsibility rather than the utility's. This error is particularly problematic in a rate case such as this where it is the utility that has custody of all of the necessary information.<sup>6</sup> Any gaps in the record in this matter are the fault of Lake Region and should have weighed against Lake Region in the final decision.

Furthermore, in its analysis of Staff's prudence argument, the Commission improperly accorded a presumption of prudence to Lake Region, contrary to a recent holding of the Missouri Supreme Court that such a presumption exists only in the case of an arm's-length transaction.<sup>7</sup> Lake Region's shareholders caused Lake Region to assign the valuable availability fees revenue stream to themselves and that was hardly an arm's-length transaction; rather, it was looting. Consequently, it was not Staff's burden to show that the assignment was imprudent, but rather Lake Region's burden to show that it was not.<sup>8</sup>

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<sup>5</sup> *Report & Order*, pp. 42-43 (footnotes omitted).

<sup>6</sup> Lake Region, its shareholders and affiliates did everything in their power to impede discovery in this case.

<sup>7</sup> ***Office of Public Counsel v. Missouri Pub. Serv. Comm'n***, 409 S.W.3d 371, 379 (Mo. banc 2013).

<sup>8</sup> *Id.*: "The PSC used the presumption of prudence to shift the burden from Atmos, which should have been required to show that it complied with the affiliate transaction rules, and instead placed the burden on staff to show that Atmos did not do so."

5. Ultimately, the Commission decided, on public policy grounds, neither to impute the availability fees revenue to the Company nor to use it to reduce rate base as recommended by OPC. Had the errors discussed in the preceding paragraph not been made, this decision would, presumably, have been the same. Therefore, Staff believes that OPC has not shown sufficient grounds for rehearing.

**B. Inclusion of a return on equity of 11.93%:**

6. OPC contends that the Commission's award of an ROE of 11.93% is "unjust and unreasonable, unsupported by substantial and competent evidence, is against the weight of the evidence considering the whole record, is unauthorized by law, and constitutes an abuse of discretion."<sup>9</sup>

7. OPC's contentions are without merit. In determining rates, a regulatory body is "not bound to the use of any single formula or combination of formulae."<sup>10</sup> The question is whether the regulatory body's "order 'viewed in its entirety' meets the requirements" of the law.<sup>11</sup> "[I]t is the result reached not the method employed which is controlling."<sup>12</sup>

It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry ... is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.<sup>13</sup>

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<sup>9</sup> OPC's *Application for Rehearing*, p. 5.

<sup>10</sup> **Fed. Power Comm'n v. Hope Natural Gas Co.**, 320 U.S. 591, 602, 64 S.Ct. 281, \_\_\_, 88 L.Ed. 333, \_\_\_ (1944).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*; **State ex rel. Office of Public Counsel v. Public Service Com'n**, 367 S.W.3d 91, 108 (Mo. App., S.D. 2012).

8. The Commission accepted Staff's recommendation on ROE. It is fully supported by the testimony of Staff's expert witness, Shana Atkinson. The Commission as trier of fact may believe some, all, or none of any witness' testimony.<sup>14</sup>

9. The Commission rejected OPC's recommendation on return on equity as not credible, stating: "Public Counsel's recommendation is not persuasive because it did not provide sufficient analysis to demonstrate that its recommended return is consistent with current market costs or would support Lake Region's financial integrity and access to capital markets."<sup>15</sup>

### **C. Inclusion of breach-of-contract lawsuit fees and expenses in rates:**

10. OPC contends that the Commission's inclusion in rates of legal fees and litigation expenses relating to an ultimately unsuccessful breach-of-contract lawsuit is "unjust and unreasonable, unsupported by substantial and competent evidence, is against the weight of the evidence considering the whole record, is unauthorized by law, and constitutes an abuse of discretion."<sup>16</sup>

11. As OPC points out, §§ 393.130 and 393.140, RSMo, require the Commission to ensure that all rates set by the Commission are just and reasonable, which is generally taken to mean that only reasonable, necessary and prudent operating and other business expenses are charged to ratepayers. The Commission's recitation of the reasons it found for Lake Region on this issue reveal that it was persuaded that the expenses in question were, in fact, reasonable, necessary and prudent utility business expenses:

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<sup>14</sup> *State ex rel. GS Technologies Operating Co. v Public Service Commission*, 116 S.W.3d 680, 690 (Mo. App., W.D. 2003); *State ex rel. Associated Natural Gas Co. v. Public Service Commission*,

<sup>15</sup> *Report and Order*, p. 50.

<sup>16</sup> *OPC's Application for Rehearing*, p. 8.

Lake Region incurred the legal expenses at issue defending a position that would have allowed the company to avoid increased costs. If Lake Region had ultimately been successful, it would have had to pay less money to SB Development regarding the 1998 contract dispute. The fact that Lake Region did not prevail on appeal does not make its decision to participate in the appeal imprudent, especially considering that Lake Region was successful at the circuit court level. Lake Region pursued a reasonable course of action by participating in the appeal of this case in an attempt to avoid increased costs. The Commission concludes that the legal fees incurred by Lake Region in defending the circuit court case and participating in the appeal, including the \$520.10 incurred during the true-up period, were reasonable and should be included in the calculation of rates for Lake Region.<sup>17</sup>

12. Staff concludes that the Commission made no error with respect to this issue. Although the Commission discussed the presumption of prudence in its *Report and Order*,<sup>18</sup> the cited language shows that it did not apply it. Instead, the Commission reviewed the facts surrounding the fees and litigation expenses and determined that these expenditures were not imprudent. If the Commission had applied the presumption of prudence in its analysis of this issue, that would not have been error as these were arm's-length transactions.

13. Because OPC has not shown any significant errors, the Commission should DENY OPC's application for rehearing.

***Lake Region Water and Sewer Company:***

14. In its *Application for Rehearing*, Lake Region notes that its application is strictly limited to "the Commission's conclusion that it has statutory authority, hence jurisdiction, to consider availability fees, which are fees charged by a non-utility entity for non-utility services, as defined by statute, in determining whether Lake Region's

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<sup>17</sup> *Report and Order*, pp. 52-53.

<sup>18</sup> At p. 51.

proposed rate increase is just and reasonable.”<sup>19</sup> Lake Region contends that the Commission’s determination that it has jurisdiction over the issue is “unlawful, unjust and unreasonable and just grounds exist for the Commission to rehear the jurisdictional issue.”<sup>20</sup>

15. Throughout its application, Lake Region repeatedly references the definition of “service.”<sup>21</sup> Essentially, the claim is that nothing can be within the jurisdiction of the Commission that does not fit into Lake Region’s narrow interpretation of service.<sup>22</sup>

16. Lake Region’s attempt to pigeonhole the investigatory obligation and powers of the Commission cannot be given credence. Section 393.270.1, RSMo., states “[a]n investigation may be instituted by the commission as to any matter of which complaint may be made as provided in sections 393.110 to 393.285, *or to enable it to ascertain the facts requisite to the exercise of any power conferred upon it*”(emphasis added).<sup>23</sup> Necessarily, the Commission is authorized to conduct investigations in the course of setting just and reasonable rates. The statute further clarifies the Commission’s authority to consider all facts:

4. In determining the price to be charged for gas, electricity, or **water the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations**

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<sup>19</sup> *Lake Region’s Application for Rehearing*, pp. 1-2.

<sup>20</sup> *Id.*, p. 2.

<sup>21</sup> *Id.*

<sup>22</sup> Staff disagrees with Lake Region’s interpretation.

<sup>23</sup> In its argument to limit the Commission’s investigatory authority, Lake Region cites §393.260.1 RSMo. “the commission is limited to the hearing of complaints that are strictly about the price and quality of water and sewer *service*, as provided in Section 393.260.1.” Staff notes that this particular statute describes complaints brought by customers and does not address limitations on a request for a general rate increase.

**contained therein**, with due regard, among other things, to a reasonable average return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

5. In determining the price to be charged for **sewer service the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein**, with due regard, among other things, to a reasonable average return upon the value of the property actually used in the public service and to the necessity of making reservations out of income for surplus and contingencies (emphasis added).<sup>24</sup>

Furthermore, the Missouri Supreme Court has long held that the Commission must evaluate all relevant factors in setting just and reasonable rates.<sup>25</sup> When determining just and reasonable rates, the Commission uses traditional cost-of-service ratemaking. The Missouri Court of Appeals has described cost-of-service ratemaking as follows: "...in a rate case, the Commission [considers the] expenses and revenues, to establish a rate that will allow the company to recover its cost of service from its customers."<sup>26</sup> Staff suggests that the Commission was *required* to examine the availability fee revenue issue in determining the rate increase requested by Lake Region.

17. Lake Region states "the Commission concludes, and erroneously so, that it may consider revenue from unregulated enterprises in determining how a utility's cost of regulated service may be covered in rates."<sup>27</sup> Staff believes that this criticism mischaracterizes the Commission's *Order*. The availability fee revenue does not belong

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<sup>24</sup> § 393.270, .4 & .5, RSMo.

<sup>25</sup> *State ex rel. Util. Consumers' Council of Missouri, Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 48 (Mo. 1979).

<sup>26</sup> *State ex rel. Laclede Gas Company v. Public Service Commission*, 328 S.W.3d 316, 320 (Mo. App., W.D. 2010).

<sup>27</sup> *Lake Region's Limited Application for Rehearing*, p. 2.



to an unregulated enterprise, it is now, and has always been, a utility asset. “Section 393.190, governs the transfer of franchise or property of water and sewer corporations. Under this section a regulated utility proposing a sale of its assets must secure an order authorizing the sale from the Commission.”<sup>28</sup> Where, as here, the transfer is unauthorized, it is void as a matter of law.<sup>29</sup> As an asset of the regulated utility, the availability fees are certainly within the Commission’s jurisdiction.<sup>30</sup> The Commission has no choice but to consider this significant revenue stream that, inexplicably, the Company does not now receive. Thus, evidence on the availability fees is necessarily relevant.

18. Although it challenges the Commission’s ultimate decision to consider availability fee revenue, Lake Region’s application states “[a]s the Commission determined in the Report and Order the evidence in the record was insufficient to show that Lake Region or its predecessor imprudently assigned the availability fees to its shareholders in 1998 or used that revenue for utility purposes.”<sup>31</sup> As argued previously, the burden of proof rested with Lake Region.<sup>32</sup> Lake Region was required to prove that its proposed rate increase was just and reasonable, including its contention that the availability fees revenue was not properly to be imputed to the company.

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<sup>28</sup> ***Environmental Utilities, LLC v. Public Service Com’n***, 219 S.W.3d 256, 264 (Mo. App., W.D. 2007).

<sup>29</sup> § 393.190.1. RSMo.

<sup>30</sup> § 393.140 (1) RSMo.

<sup>31</sup> *Lake Region’s Limited Application for Rehearing*, p. 5.

<sup>32</sup> See *supra* par. 2-8.

19. Because the Commission has jurisdiction to consider availability fee revenue as a part of its evaluation of Lake Region's request for a general rate increase, the Commission should DENY Lake Region's application for rehearing.

**WHEREFORE**, Staff submits its *Response to Applications for Rehearing* filed in this matter.

Respectfully submitted,

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### **CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been mailed with first-class postage, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this **5<sup>th</sup> day of June, 2014**.

/s/ Kevin A. Thompson