

**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
Rate Increase in Water and Sewer Service	)	

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**POST-HEARING BRIEF OF THE  
OFFICE OF THE PUBLIC COUNSEL**

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Christina Baker #58303  
Office of the Public Counsel  
Governor Office Building  
200 Madison Street, Suite 650  
P.O. Box 2230  
Jefferson City, MO 65102  
Telephone: (573) 751-5565  
Facsimile: (573) 751-5562  
**christina.baker@ded.mo.gov**

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COMES NOW the Office of the Public Counsel (Public Counsel) and states for its Post-Hearing Brief as follows:

**1. Capital Structure**

**a. Should the capital structure for Lake Region be based on its actual capital structure or a hypothetical capital structure?**

It is Public Counsel's position that the capital structure for Lake Region should be based on the Company's actual capital structure.

It is also Lake Region's position that the capital structure should be based on its actual capital structure. However, it is Staff's position that a hypothetical capital structure should be used for Lake Region.

Rates must be just and reasonable and the use of an actual capital structure of a utility when setting customer rates is presumed reasonable. If an actual capital structure cannot be determined, it may be reasonable to pursue other avenues to set a capital structure based on the information known at the time. However, the evidence shows that in this case the actual capital structure was calculated by all three of the parties. Lake Region witness Mr. Summers

calculated an actual capital structure of approximately 60 percent debt and 40 percent equity.<sup>1</sup> In its Corrected Position Statement, Lake Region states more precisely that its actual capital structure is 56.2% debt and 43.8% equity.<sup>2</sup> Public Counsel witness Mr. Robertson calculated Lake Region's actual capital structure at the end of the test year to be 68.90% debt and 31.10% equity, based on Public Counsel's recommended availability fee adjustments.<sup>3</sup> Even Staff calculated an actual capital structure when it determined that as of the test year Lake Region is financed with 100% debt.<sup>4</sup> Since an actual capital structure can be calculated, it is just and reasonable that the actual capital structure be used in the setting of rates.

The only party advocating for a hypothetical capital structure is Staff who recommends the use of a hypothetical capital structure of 75% debt and 25% equity. Staff apparently has its own internal policy to automatically apply a 75% debt and 25% equity capital structure to any small water and sewer utility with more than 75% debt.<sup>5</sup> So, Staff's broad-brushed policy is that all small water and sewer systems should be treated as having at least 25% equity, whether or not they do. But, the evidence shows that Staff didn't test the reasonableness of Lake Region's actual capital structure first to see whether or not it is consistent with the business risk and the financial risk included in the methodology Staff is advocating to use in this case.<sup>6</sup> Nor did Staff explain how its internal policies are better than the decisions of the utility itself. In its testimony, Lake Region states that its recent financing case, WF-2013-0118, was filed with the intent to issue debt in order to create an actual capital structure of approximately 60% debt and 40%

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<sup>1</sup> Tr. Pg. 146.

<sup>2</sup> Lake Region Water & Sewer Company's Corrected Statement of Position on the Issues.

<sup>3</sup> OPC Exhibit #4.

<sup>4</sup> Staff Exhibit #7.

<sup>5</sup> Tr. Pg. 162, 195-196.

<sup>6</sup> Tr. Pg. 150-151.

equity to support the Company's rate base investment.<sup>7</sup> Therefore, the establishment of approximately the current actual capital structure must have been important to Lake Region and its shareholders. The evidence shows that Lake Region fully intended to utilize its actual capital structure and made specific business decisions to generate a specific capital structure. There is no evidence that Staff's internal policy is more reasonable than the specific business decisions of Lake Region or any other utility.

The evidence shows that in this case the actual capital structure was calculated by all three of the parties. Still Staff argues that a hypothetical capital structure should be imposed. Staff's broad-brushed internal policy is that all small water and sewer systems should be treated as having at least 25% equity. But, since an actual capital structure can be (and has been) calculated, it is just and reasonable that the actual capital structure be used in the setting of rates. The evidence shows that Lake Region fully intended to utilize its actual capital structure and made specific business decisions to generate a very specific actual capital structure. There is no evidence that Staff's internal policy is more reasonable than the specific business decisions of Lake Region or any other utility. Therefore, the Commission should order that the capital structure for Lake Region should be based on its actual capital structure.

**b. If the capital structure for Lake Region should be based on its actual capital structure, what is Lake Region's actual capital structure?**

It is Public Counsel's position that Lake Region's actual capital structure at the end of the test year is 68.90% debt and 31.10% equity.

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<sup>7</sup> WF-2013-0118, *In the Matter of Lake Region Water and Sewer Co. for Authority to Borrow Up to \$2,000,000 in Long-Term, Secured Debt*; Lake Region Exhibit #2.

It is Lake Region's position that the Company's actual capital structure at the end of the test year is 56.2% debt and 43.8% equity. It is Staff's position that as of the end of the test year Lake Region is financed with 100% debt.

As of June 30, 2013, the Company's rate base per Staff's Direct Testimony filing consisted of Horseshoe Bend Sewer - \$1,274,431, Shawnee Bend Sewer - \$276,864, and Shawnee Bend Water - \$1,084,271 for a total rate base of \$2,635,566.<sup>8</sup> The only debt in the Lake Region's name at that date was an Alterra Bank loan of \$1,396,731 with an interest rate of 5%.<sup>9</sup> Thus, Lake Region's capital structure per Staff's Direct Testimony consisted of approximately 53.00% debt and 47.00% equity at that time.<sup>10</sup> As of its February 10, 2014, filing, Lake Region calculated that its actual capital structure was 56.2% debt and 43.8% equity based on figures within Staff's most recent accounting runs.<sup>11</sup>

However, based on Public Counsel's recommended availability fee adjustments as discussed later, the inclusion of additional contributions in aid of construction (CIAC) in the Shawnee Bend Sewer and Shawnee Bend Water rate bases is warranted.<sup>12</sup> The evidence shows that it is just and reasonable for the Commission to reduce the Shawnee Bend water system rate base by the inclusion of additional CIAC in the amount of \$331,330, and to reduce the Shawnee Bend sewer system rate base by the inclusion of additional CIAC in the amount of \$705,843 due to Public Counsel's estimates of the amount of availability fees collected.<sup>13</sup> Public Counsel did not present its estimates of availability fees billed and/or collected as actual amounts because only Lake Region and its shareholders have access to that information.<sup>14</sup> Lake Region has the

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<sup>8</sup> OPC Exhibit #4.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> Lake Region Water & Sewer Company's Corrected Statement of Position on the Issues.

<sup>12</sup> OPC Exhibit #4.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

burden to prove that the amount of rate base it proposes to include in rates is just and reasonable. However, Lake Region did not provide any evidence to refute Public Counsel's calculations or methodology even though it was given ample opportunity. Therefore, the rate bases of the three utilities consist of Horseshoe Bend Sewer - \$1,274,431, Shawnee Bend Sewer - (\$428,979) (i.e., \$276,864 less \$705,843), and Shawnee Bend Water - \$752,941 (i.e., \$1,084,271 less \$331,330).<sup>15</sup> Since the adjustment drives the Shawnee Bend Sewer rate base negative, no return, i.e., neither debt nor equity, should be authorized for that system and the rate base should be set at zero.<sup>16</sup> Therefore, the rate bases of the three utilities should consist of Horseshoe Bend Sewer - \$1,274,431, Shawnee Bend Sewer - \$0, and Shawnee Bend Water - \$752,941, for a total rate base of \$2,027,372.<sup>17</sup> Since this rate base is supported by the Alterra Bank loan of \$1,396,731, Lake Region's actual capital structure is 68.90% debt and 31.10% equity.<sup>18</sup>

The positions of the parties show that Public Counsel and Lake Region have somewhat similar actual capital structure calculations, aside from Public Counsel's recommended availability fee adjustments. However, Staff calculates Lake Region's actual capital structure as containing 100% debt.<sup>19</sup> The fundamental difference between the actual capital structure recommendations centers around the ratemaking treatment of a loan Lake Region's shareholders utilized to finance the original acquisition of the utility.<sup>20</sup> Public Counsel and Lake Region did not include the shareholder acquisition loan in their calculated actual capital structure while Staff utilized the shareholder acquisition loan in its actual capital structure calculation and its ultimate recommendation to move to a hypothetical capital structure.<sup>21</sup> Staff indicates the reason it

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<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> Staff Exhibit #7.

<sup>20</sup> OPC Exhibit #3; Lake Region Exhibit #2.

<sup>21</sup> Tr. Pg. 168; OPC Exhibit #3; Lake Region Exhibit #2; Staff Exhibit #7.

included the shareholder acquisition loan in this case was due to the fact that it had included the entire amount of the shareholder acquisition loan in its capital structure recommendation in Lake Region's previous rate cases, SR-2010-0110 and WR-2010-0111.<sup>22</sup> Staff points out in these cases, Lake Region and Staff agreed (and Public Counsel did not oppose) that Staff's proposed capital structure was the most accurate.<sup>23</sup> Staff also points out its concern that regardless of whether Lake Region's assets were pledged directly or indirectly through shareholder interest, the lender would ultimately take possession of Lake Region if there was a default on the shareholder acquisition loan, which would have the same effect as if the lender foreclosed on Lake Region's assets.<sup>24</sup> While Public Counsel shares Staff's concerns, the shareholder acquisition loan is not in Lake Region's name and a Release of Negative Pledge Agreement was recently executed clearly indicating to the lender the shareholders' intent that Lake Region's assets are not to be pledged as collateral for the shareholder acquisition loan.<sup>25</sup> Therefore, Public Counsel did not include the shareholder acquisition loan in its actual capital structure calculation. Without the addition of the shareholder acquisition loan, Staff's calculated actual capital structure would be very similar to the calculations of Public Counsel and Lake Region.

Based on Public Counsel's recommended availability fee adjustments, the inclusion of additional CIAC in the Shawnee Bend Sewer and Shawnee Bend Water rate bases is warranted. Therefore, the rate bases of the three utilities consist of Horseshoe Bend Sewer - \$1,274,431, Shawnee Bend Sewer - \$0, and Shawnee Bend Water - \$752,941 for a total rate base of \$2,027,372. Since this rate base is supported by the Alterra Bank loan of \$1,396,731, Lake Region's actual capital structure is 68.90% debt and 31.10% equity. Therefore, if the

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<sup>22</sup> Staff Exhibit #7.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> OPC Exhibit #4; Lake Region Exhibit #6.

Commission determines that the capital structure for Lake Region should be based on its actual capital structure, the Commission should order that that Lake Region's actual capital structure is 68.90% debt and 31.10% equity.

**c. If the capital structure for Lake Region should be based on a hypothetical capital structure, what is a balanced and reasonable capital structure for Lake Region?**

As it is Public Counsel's position that the capital structure for Lake Region should be based on the Company's actual capital structure, Public Counsel did not state a specific position on this question prior to the hearing. However, Public Counsel reserved the right to express a final position on this question based on the testimony provided at the hearing.

It is Lake Region's position that a balanced and reasonable hypothetical capital structure for Lake Region would be 60% debt and 40% equity. It is Staff's position that a hypothetical capital structure of 75% debt and 25% equity should be utilized for Lake Region.

A reasonable capital structure finding by the Commission must balance the needs of the customers with the needs of the utility. Rates must be just and reasonable and the use of an actual capital structure of a utility when setting customer rates can be presumed reasonable. If an actual capital structure cannot be realistically determined, it may be reasonable to pursue other avenues to set a capital structure based on the information known at the time. Any hypothetical capital structure should strive to provide a reasonable recognition of the actual equity present in the utility. Randomly adding additional equity to the utility provides a windfall for shareholders in the form of a return for investment that does not exist. As a result, a rule of thumb should be that a reasonable hypothetical capital structure includes an equity percent which is within a reasonable range of the actual equity percent. This will allow for recognition of the actual equity



while preventing the requirement for customers to pay rates based on an unreasonable amount of non-existent equity.

The evidence shows that Public Counsel calculated the actual capital structure at true-up for Lake Region to be 68.90% debt and 31.10% equity, based on Public Counsel's recommended availability fee adjustments.<sup>26</sup> As the actual percentage of equity for Lake Region has been shown to be 31.10%, per the rule of thumb a reasonable hypothetical structure would include an equity percent which is within a reasonable range of 31.30%. Therefore, if a hypothetical structure is to be used, the Commission could determine that a balanced and reasonable capital structure would be 70% debt and 30% equity as it includes an equity percent which is within a reasonable range of the actual equity percent calculated by Public Counsel.

Similarly, Lake Region calculated the actual capital structure at the end of the test year to be 56.2% debt and 43.8% equity.<sup>27</sup> In its testimony, Lake Region states that its recent financing case, WF-2013-0118, was filed with the intent to issue debt in order to create an actual capital structure of approximately 60% debt and 40% equity to support the Company's rate base investment.<sup>28</sup> Based on this, Lake Region stated its position that a balanced and reasonable hypothetical capital structure for Lake Region would be 60% debt and 40% equity. Lake Region's hypothetical capital structure includes an equity percent which is within a reasonable range of the actual equity percent calculated by Lake Region. However, 40% equity unreasonably exceeds the actual equity percent calculated by Public Counsel.

Staff is proposing a hypothetical capital structure of 75% debt and 25% equity. However, Staff's position is pure fiction with no connection to the realities of Lake Region. Staff's

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<sup>26</sup> OPC Exhibit #4.

<sup>27</sup> Lake Region Water & Sewer Company's Corrected Statement of Position on the Issues.

<sup>28</sup> WF-2013-0118, *In the Matter of Lake Region Water and Sewer Co. for Authority to Borrow Up to \$2,000,000 in Long-Term, Secured Debt*; Lake Region Exhibit #2.

calculations show that as of the end of the test year Lake Region is financed with 100% debt.<sup>29</sup> But, in stark contrast to the actual capital structure Staff calculated, Staff argues that a hypothetical capital structure of 75% debt and 25% equity should be utilized for Lake Region.<sup>30</sup> In essence, Staff is saying it believes customers should pay rates that include a return on 25% equity that does not actually exist. A shift from 0% equity to 25% equity is excessive and does not meet the rule of thumb that a reasonable hypothetical capital structure should include an equity percent which is within a reasonable range of the actual equity percent. Such a drastic move is most certainly detrimental to the customers.

To support to this amount of equity shift, Staff points to its own internal policy to automatically apply a 75% debt and 25% equity capital structure to any small water and sewer utility with more than 75% debt.<sup>31</sup> Therefore, no matter what the actual capital structure was calculated to be, Staff's policy would be to require customers' rates to include a return of at least 25% equity. Staff just applies this internal policy automatically without making any determination on how it balances the needs of the utility and the needs of the customers.<sup>32</sup> According to Staff, because it believes there are practical limitations on estimating the cost of equity at such extreme levels of leverage, Staff feels it is necessary to automatically cap the leverage ratio at 75% debt.<sup>33</sup> But none of the parties, including Staff should have any difficulty estimating the cost of equity for Lake Region especially since Lake Region had a recent financing Case No. WF-2013-0118 for a loan which authorized a debt cost of 5.00%.<sup>34</sup> Therefore, Staff's concerns seem to be unfounded in this case. Staff didn't even test the reasonableness of

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<sup>29</sup> Staff Exhibit #7.

<sup>30</sup> *Id.*

<sup>31</sup> Tr. Pg. 162, 195-196.

<sup>32</sup> Tr. Pg. 162.

<sup>33</sup> OPC Exhibit #4.

<sup>34</sup> WF-2013-0118, *In the Matter of Lake Region Water and Sewer Co. for Authority to Borrow Up to \$2,000,000 in Long-Term, Secured Debt*; Lake Region Exhibit #2; OPC Exhibit #4;

Lake Region's actual capital structure first to see whether or not it was consistent with the business risk and the financial risk included in the methodology Staff is advocating to use in this case.<sup>35</sup> Staff made no determination of the affordability or economic impact of requiring Lake Region's customers to pay a return on 25% equity that does not exist.<sup>36</sup> Additionally, Staff's internal policy applies only to small water and sewer companies that are above 75% debt and its result is to help ensure that all small water and sewer utility owners or shareholders receive a profit no matter what.<sup>37</sup> Staff makes no similar adjustment to lower the equity portion of those utilities that have 100% equity to relieve the burden placed on the customers and promote affordability. As a result, Staff's internal policy is one sided with the benefit going to the utility without offering a reciprocal benefit for the customers. This completely goes against Staff's mandate to equally balance the needs of the utility with the needs of the customers.

Applying a hypothetical capital structure to every small water and sewer system without making a determination that it balances the needs of the utility and the customers is not a reasonable position for Staff to take. Staff's broad-brushed position that all small water and sewer systems should be treated as having at least 25% equity may be reasonable help to prop up a troubled system that has no equity and is need of cash flow. But that should only be approved by the Commission on a case-by-case basis. There is no evidence that this internal policy of Staff is just and reasonable to be applied automatically, especially where Staff's actual capital structure calculation of more than 75% debt differs from the calculations of other parties. Staff's internal policy to automatically apply a 75% debt and 25% equity capital structure may actually be detrimental to the utility as in this case where both Public Counsel and Lake Region calculate an actual capital structure that exceeds 25% equity. Evidence has been presented that shows that

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<sup>35</sup> Tr. Pg. 150-151, 162-163.

<sup>36</sup> Tr. Pg. 162-163.

<sup>37</sup> Tr. Pg. 195-196.

Lake Region has less than 75% debt. Therefore, it is not just and reasonable for the Commission to support Staff's internal policy of automatically applying a hypothetical capital structure of 75% debt and 25% equity to Lake Region.

Public Counsel continues to believe quite strongly that the capital structure for Lake Region should be based on the Company's actual capital structure, especially since every party was able to calculate an actual capital structure for Lake Region. However, Public Counsel has tried to answer the question before the Commission so that if the Commission determines that the capital structure for Lake Region should be based on a hypothetical capital structure, a balanced and reasonable capital structure can be determined. There is no evidence that Staff's position is a fair balance of the needs of the utility versus the needs of the customers. Therefore, the Commission should disregard Staff's internal policy of automatically setting the hypothetical capital structure to 75% debt and 25% equity for all small water and sewer utilities which Staff calculates to have more than 75% debt. The evidence shows that Public Counsel calculated the actual capital structure at true-up for Lake Region to be 68.90% debt and 31.10% equity. Therefore, if a hypothetical structure is to be used, the Commission could determine that a balanced and reasonable capital structure would be 70% debt and 30% equity as it includes an equity percent which is within a reasonable range of the actual equity percent calculated by Public Counsel.

## **2. Return on Equity**

### **a. What is the appropriate return on equity for Lake Region?**

It is Public Counsel's position that Lake Region's current Commission authorized return on equity of 8.50% be authorized again by the Commission in this case.

It is Staff's position that the appropriate return on equity for Lake Region is 13.89% if applied to Staff's hypothetical common equity ratio of 25%. Alternatively, if the Commission accepts the capital structure proposed by Lake Region (or presumably that proposed by Public Counsel), Staff recommends a lower return on equity of 11.93%. It is Lake Region's position that the appropriate return on equity for Lake Region is 13.89% as recommended by Staff.

An important part of a just and reasonable rate is an authorized return on equity that is neither excessive nor confiscatory. A reasonable return on equity, as developed by the United States Supreme Court decisions in the *Bluefield* and *Hope*<sup>38</sup> cases, is: (1) adequate to attract capital at reasonable terms, thereby enabling the utility to provide safe and reliable service; (2) sufficient to ensure the utility's financial integrity; and (3) commensurate with returns on investments in enterprises having corresponding risks.

The evidence shows that Lake Region's current Commission authorized return on equity of 8.50% continues to be just and reasonable in this case. Staff's direct testimony recommendation incorporated a hypothetical capital structure of 75.00% debt and 25.00% equity with a common equity return of 13.89% and a debt cost of 5.00%.<sup>39</sup> In its surrebuttal testimony, Staff reiterated its original recommendation but stated that if a less-leveraged capital structure were used to set Lake Region's rates Staff would lower its recommended return on equity to 11.93%.<sup>40</sup> Lake Region's direct testimony incorporated an actual capital structure of 59.90% debt and 40.10% equity based on its proposed net rate base along with a common equity return of 11.07% and a debt cost of 5.00% for the loan authorized in Lake Region's recent financing Case No. WF-2013-0118.<sup>41</sup> However, Lake Region changed its recommendation to embrace Staff's significantly higher 13.89% return on equity,

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<sup>38</sup> *Bluefield Waterworks and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923); *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).

<sup>39</sup> Staff Exhibit #3.

<sup>40</sup> Staff Exhibit #7.

<sup>41</sup> OPC Exhibit #4.

stating that it found “Staff’s estimated return on equity to be generally consistent with the Company’s proposed capital structure mix, and is reasonable in light of the Company’s intention to use a verifiable capital structure.”<sup>42</sup> Lake Region stated its position at hearing that the Company’s actual capital structure at the end of the test year was 56.2% debt and 43.8% equity indicates that the capital structure remained similar to its original calculations.<sup>43</sup> Lake Region made no indication that it embraced Staff’s lowered recommended return on equity of 11.93% even though Lake Region’s proposed actual capital structure would be less-leveraged than Staff’s.

The evidence shows that 13.89% return on equity proposed by Staff, and now accepted by Lake Region, is not reasonable or appropriate. Staff’s 13.89% proposal is based on a hypothetical capital structure which does not exist and is not supported by the evidence since Lake Region does not have a debt load equal to or exceeding the 75% Staff supports.<sup>44</sup> As a nod to the evidence of the actual capital structure presented by the other parties, Staff alternatively recommends a lower return on equity of 11.93% if the Commission accepts a less leveraged capital structure.<sup>45</sup> Staff is saying if the Commission utilizes Staff’s calculations regarding capital structure, the reasonable return should be 13.89%. But, if the Commission utilizes Lake Region’s calculated actual capital structure of 56.2% debt or presumably Public Counsel’s calculated actual capital structure of 68.90% debt, Staff believes the reasonable return should be set at 11.93%. Staff’s alternative reflects the accepted premise that the lower the amount of debt in the utility’s capital structure, the lower the risk and therefore the lower the reasonable return on equity. Lake Region does not seem to embrace this fact as its position statement indicates its continuing belief that the appropriate return on equity for Lake Region is 13.89%, no matter what amount of debt Lake Region is determined to have.

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<sup>42</sup> Lake Region Exhibit #5.

<sup>43</sup> Lake Region Water & Sewer Company’s Corrected Statement of Position on the Issues.

<sup>44</sup> Staff Exhibit #3; Staff Exhibit #7; OPC Exhibit #4.

<sup>45</sup> Staff Exhibit #7.

Staff's recommendation is an extrapolation of returns for large publicly traded companies which Lake Region is not and has no resemblance to.<sup>46</sup> That methodology may be fine as a last resort if a reasonable return cannot be determined in any other way. However, Lake Region currently has a reasonable 8.50% authorized return which should be considered by the Commission before applying Staff's last resort methodology.

In Lake Region's last rate cases, SR-2010-0110 and WR-2010-0111, Staff witness Ms. Atkinson recommended that the Commission authorize return on common equity of 8.00% to 9.00% as applied to Lake Region's September 30, 2009, actual capital structure of 16.36% equity and 83.64% debt.<sup>47</sup> In that case all the parties, including Lake Region, agreed that the 8.50% mid-point of Staff's recommended return on equity range of 8.00% to 9.00% was a reasonable return on equity.<sup>48</sup> This indicates that Lake Region agreed with Staff and Public Counsel that an 8.50% return on equity was a sufficient reflection of the risk Lake Region faced in 2009.

Since the last cases, the evidence shows that Lake Region's risk is similar if not lower than it was in 2010.<sup>49</sup> The accepted premise is that the lower the amount of debt in the utility's capital structure, the lower the risk and therefore the lower the reasonable return on equity. On the flip side, the higher the amount of debt in the utility's capital structure, the higher the risk and therefore the higher the reasonable return on equity. The evidence shows that in 2009, Lake Region's actual capital structure was calculated by Staff to be 16.36% equity and 83.64% debt.<sup>50</sup> In this case, Public Counsel calculated Lake Region's actual capital structure at the end of the test year to be 68.90% debt and 31.10% equity.<sup>51</sup> Similarly, Lake Region calculated the Company's actual capital structure at the end of the test year to be 56.2% debt and 43.8%

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<sup>46</sup> OPC Exhibit #4.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> Tr. Pg. 163.

<sup>50</sup> OPC Exhibit #4.

<sup>51</sup> *Id.*

equity.<sup>52</sup> Therefore, the evidence shows that Lake Region's equity ratio has increased significantly since the prior case while the debt ratio has decreased significantly. As a result of increased equity and decreased debt, Lake Region is likely to be subject to less risk than it was in the last case.

While Lake Region may be categorized as a small utility, it has had no problems obtaining financing under its own name as evidenced by the recent financing case, Case No. WF-2013-0118. Nor is Lake Region operating under any undue financial or operational stress.<sup>53</sup> For its size, it is a fairly strong well-run utility and any risks it may be encountering do not appear to be insurmountable. Also the evidence shows that much of the risk that Lake Region faces is purely shareholder inflicted, not market driven.<sup>54</sup> The only debt in Lake Region's name is an Alterra Bank loan of \$1,396,731 with an interest rate of 5%.<sup>55</sup> However, the risk that Lake Region incurred due to this loan comes from a shareholder decision to remove equity from Lake Region to fund a cash payout to the shareholders.<sup>56</sup> Shareholder actions like this removal of equity to provide cash payments to shareholders does affect the amount of risk that is faced by the utility.<sup>57</sup> But, that decision was purely shareholder driven and any risk should not be placed on Lake Region and its customers but instead should be borne by the shareholders themselves through the authorized return. Shareholders also specifically removed the payment of availability fees from Lake Region as a separate cash flow and as a result eliminated a good deal of risk on behalf of the shareholder.<sup>58</sup> Customers have no say in shareholder actions and are at the mercy of Commission decisions on how much return is reflected in rates. The economy is

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<sup>52</sup> Lake Region Water & Sewer Company's Corrected Statement of Position on the Issues.

<sup>53</sup> Tr. Pg. 163.

<sup>54</sup> OPC Exhibit #4.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> Tr. Pg. 163.

<sup>58</sup> OPC Exhibit #4; Joint Stipulation of Undisputed Facts.



still suffering and reasonable returns are lower as a result. Since Lake Region's last rate case, the overall return on equity the Commission has seen in its various rate cases has decreased, not increased. There is no evidence that Staff's recommended 13.89% return on equity, or even its 11.93% alternative return on equity recommendation, is a just and reasonable reflection of shareholder risk. The authorized return on equity of 8.50% as agreed to by all the parties in Lake Region's previous cases was reasonable then and continues to be reasonable today. Therefore, the Commission should authorize a continued 8.50% return on equity as just and reasonable in this case.

### **3. Availability Fees**

#### **a. Should availability fees collected from owners of undeveloped lots in Lake Region's service territory be classified as Lake Region revenue or applied against rate base?**

It is Public Counsel's position that availability fees should be applied against rate base as contributions in aid of construction (CIAC). Specifically, Public Counsel recommends that the water system rate base be reduced by the inclusion of additional CIAC in the amount of \$331,330, and that the sewer system rate base be reduced by the inclusion of additional CIAC in the amount of \$705,843.

It is Staff's position that availability fees should be included as revenue in the calculation of rates for Lake Region. Specifically, Staff recommends that Lake Region's rates should reflect an annual amount of availability fee revenues of \$93,136 for Shawnee Bend Water and \$139,704 for Shawnee Bend Sewer. Lake Region states its objections to the inclusion of this issue on grounds that it is beyond the jurisdiction of the Commission and therefore is irrelevant and immaterial, and that a definitive and duly promulgated rule on the treatment of availability fees is

a prerequisite to Commission consideration of the issue; however no such rule has been promulgated or adopted. Reserving these objections, it is Lake Region's position that availability fees should not be classified as Lake Region revenue and should not be applied against rate base.

The jurisdiction of the Commission is set out in RSMo §386.250. Where a statute is reasonably open to construction, the Commission has the power to determine administratively its own jurisdiction. The definition of service in RSMo §386.020 can reasonably be seen to include availability charges. The definition of service includes accommodations afforded customers or patrons and includes providing a product or a commodity. Standby and availability charges are fees which are exacted for the benefit which accrues to property by the virtue of having water and sewer services available to it even though the water or sewer services might not actually be used at the present time. Lot owners gain an increase in their property values because there is an availability of water and sewer service that is ready for them when they choose to connect.<sup>59</sup> Availability fees are used to repay the utility's cost of plant and infrastructure which by design requirements must be made available.<sup>60</sup> Availability fees are also used to ensure that the utility is able to provide a state-of-the-art utility system at the time of connection whenever that may be. Without a utility present, there would be no availability charge. Contracts cannot limit regulation by the Commission. It makes no difference who ultimately collects the availability fees; the availability fee remains a charge for services provided by the utility.

Based on this statutory authority, the Commission has and does exert jurisdiction over availability fees. Ozark Shores, an affiliate company of Lake Region, charges availability fees which are added into the general revenue stream for use in determining Commission approved

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<sup>59</sup> Joint Stipulation of Undisputed Facts.

<sup>60</sup> *Id.*

rates.<sup>61</sup> Peaceful Valley also has availability fees in its Commission approved tariffs and collects the availability charges as general revenue to reserve access to its water service.<sup>62</sup> Until recently, I.H. Utilities also had availability fees in its Commission approved tariffs and collected the availability fees as general revenue.<sup>63</sup> Additionally, in Lake Region's last rate cases, the Commission determined that it should assert jurisdiction over the availability fees associated with Lake Region:

Because the utility had, at different intervals, direct use of or access to this revenue stream, and because the fees can be defined as a commodity falling under the definition of utility service, **the Commission concludes that it should assert jurisdiction over availability fees.**<sup>64</sup> [emphasis added]

This determination of Commission jurisdiction over availability fees continues to be just and reasonable in Lake Region's current rate case.

There is a nexus between the service provided by Lake Region and the availability fees. Lake Region provides a costly commodity, water and sewer availability, through the utility's plant and infrastructure for which undeveloped lot owners are required to pay. The annual availability fees of \$300 for each undeveloped lot is specifically for both water and sewer availability from Lake Region.<sup>65</sup> Future customers pay availability fees to reserve their spot on Lake Region's water and sewer utility once they are ready to connect. There are consequences for non-payment of the availability fees. The Declaration of Restrictive Covenants (as ultimately amended) applicable to the lots located in Lake Regions' service area require undeveloped lot owners to pay availability fees and state that unpaid availability charges will become a lien on the lot or lots to which they are applicable as of the date they became due.<sup>66</sup> The parties agree

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<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> Report and Order, *Lake Region Water & Sewer Company*, Case Nos. SR-2010-0110 and WR-2010-0111, pg. 103.

<sup>65</sup> Joint Stipulation of Undisputed Facts.

<sup>66</sup> *Id.*

that the purpose for establishing the availability fees applicable to Lake Region's service area was to recover the investment in the water and sewer systems, not to maintain or repair the existing operations of the systems once they were constructed.<sup>67</sup> Investment is not a one-time proposition connected only to the original development of Lake Region. Investment is an ongoing process for Lake Region in order to maintain a state-of-the-art system. It makes no difference who ultimately collects the availability fees; the availability fee remains a charge for services provided by Lake Region. Lake Region and its shareholders should not be allowed to contract themselves out of Commission regulation. Therefore, the Commission should find once again that it does have jurisdiction over the availability fees associated with Lake Region and Lake Region's objections should be denied.

If the Commission does determine that it has jurisdiction over the availability fees associated with Lake Region, it is important for the Commission to ensure that both Lake Region's current customers and those future customers who are subject to paying the availability fees receive all the benefit they are due from the availability fees. Lake Region's customer rates are designed so that the Lake Region's investment is recovered over time from those who utilize the water and sewer services it provides. Similarly, the parties agree that the purpose for establishing the availability fees in Lake Region's service area was to recover the investment in the water and sewer systems, not to maintain or repair the existing operations of the systems once they were constructed.<sup>68</sup> It is important for the Commission to insure that all investment and subsequent recovery is accounted for and balanced so that investment is not over-recovered. If investment is being recovered through the payment of availability fees, it is not just and reasonable to expect customers to pay for that investment as well. Therefore the Commission

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<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

must set rates that incorporate any and all availability fee payments made for the purpose of investment recovery for Lake Region's water and sewer systems.

It is just and reasonable that the availability fees be accounted for ultimately in the rates paid by the customers. This can be accomplished through classifying the availability fees as Lake Region revenue or applying the availability fees against Lake Region's rate base. Staff asserts that the Commission should include the availability fees as revenue in the calculation of rates for Lake Region. Specifically, Staff recommends that Lake Region's rates should reflect an annual amount of availability fee revenues of \$93,136 for Shawnee Bend Water and \$139,704 for Shawnee Bend Sewer.<sup>69</sup> Staff believes the availability fees could be used to maintain the system, thus the fees should be considered as revenue in the costs of service.<sup>70</sup> In Lake Region's last rate cases, the Commission determined that it would be unreasonable to do so for availability fees already collected:

After considering all of the possible revenue scenarios, the relevant law, and the Commission's prior policy and practice on ratemaking treatment of availability fees, the Commission determines that the substantial and competent evidence in the record as a whole supports the conclusion that it would be unjust and unreasonable to impute additional revenue to Lake Region derived from the availability fees already collected.<sup>71</sup>

Therefore, Staff's recommendation is based on the amount availability fees collected during the test year as a reasonable indicator of future annual availability fee collections. However, Staff's recommendation would remove a significant amount of revenue from Lake Region while maintaining a higher rate base on which shareholder returns are calculated. This would, without a doubt, lower rates for customers but would not provide any acknowledgement that shareholders specifically removed the payment of availability fees from Lake Region as a separate cash

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<sup>69</sup> Staff Exhibit #8.

<sup>70</sup> *Id.*.

<sup>71</sup> *Lake Region Water & Sewer Company*, Case Nos. SR-2010-0110 and WR-2010-0111, Report and Order, pg. 107.

flow.<sup>72</sup> Shareholders would reap the benefit of not only collecting the availability fees but also of collecting higher returns for investment the availability fees were meant to pay for. Therefore, Staff's recommendation may not be the most just and reasonable solution in this case.

While the Commission's previous determination may have been that the availability fees are not necessarily revenues, the evidence shows that it is just and reasonable for availability fees to be applied against rate base as CIAC.<sup>73</sup> CIAC represents donations and/or contributions of cash, services or property from anyone to the utility for purposes of construction.<sup>74</sup> The value of the cash, services or property is recorded in the respective plant account and an offsetting amount is recorded in a liability account which is utilized to reduce rate base when the cost of service for the utility is determined.<sup>75</sup> It is important to note that the parties agree that the purpose for establishing the availability fees in Lake Region's service area was to recover the investment in the water and sewer systems, not to maintain or repair the existing operations of the systems once they were constructed.<sup>76</sup> Investment is not a one-time proposition connected only to the original development of the utility. Investment is an ongoing process for a utility in order to maintain a state-of-the-art system. Estimates show that the amount of availability fees presumed collected far exceeds the cost of the original investment in the water and sewer systems.<sup>77</sup> As the purpose of the availability fees is to recover investment in the water and sewer systems, the purpose for any availability fee money collected above and beyond the original investment in developing the systems would logically be to recover the ongoing investment to the systems.

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<sup>72</sup> OPC Exhibit #4; Joint Stipulation of Undisputed Facts.

<sup>73</sup> OPC Exhibit #2.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> Joint Stipulation of Undisputed Facts.

<sup>77</sup> OPC Exhibit #4.

This is logical given the fact that the availability fees were established not for a short amount of time, but to continue in perpetuity until all the lot owners become connected to Lake Region's water and sewer system. There is no provision that states that once a certain amount of money is collected the availability fees will go away.<sup>78</sup> In fact, the way the Declaration that contains the requirement for undeveloped lots to pay availability fees is written, the default is that the availability fees will never go away. The Declaration states it is binding until January 15, 2015, after which it is automatically renewed unless the owners of 90% of the lots vote to terminate the Declaration. Owners of undeveloped lots have no specific timeline to connect to utility service. So, other than through the unlikely event of gaining a 90% vote for complete termination, the undeveloped lot owners have way of terminating the availability fees. And anyone would agree that 90 percent agreement is a huge hurdle to meet even in the best circumstances. Therefore, availability fees will more than likely continue for the foreseeable future just as they were apparently intended.

The evidence shows that availability fees have been and will continue to be collected long after the original investment in Lake Region was recovered. Lake Region's rate base is overstated due to the fact that the full amount of availability fees collected from lot owners within the utility's jurisdictions has not been utilized to offset the cost of the original and subsequent plant investments made by the utility.<sup>79</sup> Throughout the case, Lake Region and its shareholders consistently refused to provide information that would allow the parties to identify accurately, without estimation, the amount of contributions in aid of construction (i.e., donated investment) is associated with the individual utility's plant-in-service or the actual amount of availability fees billed and collected by the utility, the utility shareholders or the developer of the

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<sup>78</sup> Joint Stipulation of Undisputed Facts.

<sup>79</sup> OPC Exhibit #3.

systems over the years.<sup>80</sup> Despite that, Public Counsel was able to prepare an analysis that showed the estimated amounts for availability fees collected within the Shawnee Bend Water and Sewer operations jurisdiction in comparison to the stated investment donated by the original developers.<sup>81</sup> This analysis shows that during the calendar years of 1995 through 2013, approximately \$6.6 million of availability fees has been billed and/or collected by the utility and/or its owners.<sup>82</sup> Assuming that the availability fees were reasonably assigned 40% to the water system and 60% sewer system,<sup>83</sup> as of the end of calendar year 2013, \$2,639,900 of the estimated \$6.6 million were water-related fees and \$3,959,849 were sewer-related fees.<sup>84</sup> Public Counsel did not present its estimates of availability fees billed and/or collected as actual amounts because only Lake Region and its shareholders have access to that information.<sup>85</sup> However, Lake Region has the burden to prove that the amount of rate base it proposes to include in rates is just and reasonable. Lake Region did not provide any evidence to refute Public Counsel's calculations or methodology even though it was given ample opportunity. Therefore, the Commission should find that Public Counsel's calculations are reasonable estimates of availability fees billed and/or collected.

Lot owners are required to pay availability fees until they connect to the Shawnee Bend Water and Sewer systems, whenever that might be.<sup>86</sup> Lot owners are paying these fees to guarantee that a state-of-the-art utility system will be available when they are ready to connect.<sup>87</sup> Therefore, these fees are designed to recover the original cost of the utility investment along with

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<sup>80</sup> OPC Exhibit #4.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> The actual yearly fees are 40% water and 60% sewer based on monthly charges of \$10 for water and \$15 for sewer.

<sup>84</sup> OPC Exhibit #4.

<sup>85</sup> *Id.*

<sup>86</sup> OPC Exhibit #3; Joint Stipulation of Undisputed Facts.

<sup>87</sup> *Id.*



any other additional treatment capacity or other water and sewer infrastructure, such as line extensions and pumping stations, etc., required to build a state-of-the-art system to serve customers at the time they are ready to take service.<sup>88</sup> But in a way that does make sense. An undeveloped lot may sit there for years until the owner decides to connect to the utility. All the while things are changing at the utility, plant is getting older, and new regulations become applicable. Again, investment is an ongoing process for a utility in order to maintain a state-of-the-art system. Because of this ongoing investment, it is just and reasonable that the Shawnee Bend water system rate base be reduced by the inclusion of additional CIAC in the amount of \$331,330, and that the Shawnee Bend sewer system rate base be reduced by the inclusion of additional CIAC in the amount of \$705,843.<sup>89</sup> In both operations the amount of availability fees presumed collected have far exceeded the original donated investment of the developer.<sup>90</sup> This, along with the fact that availability fees will most likely continue in the future, indicates that these fees were designed to recover not only the original cost of the utility investment but also any other additional treatment capacity or other water and sewer infrastructure, such as line extensions and pumping stations, etc., required to build a state-of-the-art system to serve customers at the time they are ready to take service.<sup>91</sup>

It is just and reasonable that the additional availability fees be included in rate base as additional CIAC paid by lot owners within the jurisdiction of the Lake Region. Including availability fees in rate base as additional CIAC would acknowledge that the purpose for establishing the availability fees in Lake Region's service area was to recover the investment in the water and sewer systems and in turn lower rates for customers, preventing over recovery of

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<sup>88</sup> OPC Exhibit #3.

<sup>89</sup> OPC Exhibit #4.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

that investment. This would also acknowledge that because shareholders specifically removed the payment of availability fees from Lake Region as a separate cash flow, they should not be allowed collect higher returns for investment the availability fees were meant to pay for. Therefore, the Commission should order that availability fees collected from owners of undeveloped lots in Lake Region's service territory should be applied against rate base to reduce the Shawnee Bend water system rate base by the inclusion of additional CIAC in the amount of \$331,330, and to reduce the Shawnee Bend sewer system rate base by the inclusion of additional CIAC in the amount of \$705,843.

Should the Commission determine that it is not just and reasonable that existing rate base be reduced due to past collection of the availability fees, Public Counsel wishes to stress to the Commission that availability fees will apparently continue for the foreseeable future just as they were intended. In fact, Staff estimates that the annual amount of availability fee revenues will be \$93,136 for Shawnee Bend Water and \$139,704 for Shawnee Bend Sewer.<sup>92</sup> It is not just and reasonable that future collections of availability fees be allowed to continue without the Commission requiring that both Lake Region's customers and those future customers who are subject to paying the availability fees receive all the benefit they are due from those availability fees. As an alternative, Public Counsel would suggest that it would be just and reasonable for the Commission to order that as long as availability fees continue to be collected, rate base is to be offset in future rate cases by CIAC in the amount of \$300 for each undeveloped lot or by the amount actually collected. Including availability fees in rate base as additional CIAC would acknowledge that the purpose for establishing the availability fees in Lake Region's service area was to recover the investment in the water and sewer systems and in turn lower rates for customers preventing over recovery of that investment. This would also acknowledge that

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<sup>92</sup> Staff Exhibit #8.

because shareholders specifically removed the payment of availability fees from Lake Region as a separate cash flow, they should not be allowed collect higher returns for investment the availability fees were meant to pay for. Therefore, should the Commission determine that it is not just and reasonable that existing rate base be reduced due to past collection of the availability fees, the Commission should order that as long as availability fees continue to be collected, rate base is to be offset in future rate cases by CIAC in the amount of \$300 for each undeveloped lot or by the amount actually collected.

#### **4. Legal Fees**

- a. Should the legal fees incurred during the test year (and the true-up timeframe<sup>93</sup>) for *Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer* be included in the calculation of rates for Lake Region?**

It is Public Counsel's position that the test year and true-up legal fees for *Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer* are a non-recurring, unreasonable expense that should not be included in the calculation of rates for Lake Region.

It is Staff's position that the amount of \$15,365 in legal fees incurred by the Company during the test year in defending this appeal and the true-up amount of \$520.10 in legal fees incurred in pursuit of an Application for Transfer of the case to the Missouri Supreme Court should be included in the calculation of rates for Lake Region. It is also Lake Region's position that these test year and true-up legal fees should be included in the calculation of rates for Lake Region.

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<sup>93</sup> As legal fees is the only unresolved true-up issue, the Parties have agreed to include the true-up legal fee costs argument in the normal hearing briefs.

The issue before the Commission is whether the legal fees incurred during the test year and the true-up timeframe for *Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer* should be included in the calculation of rates for Lake Region. In order for these legal costs to be included in rates, Lake Region has the burden to prove that the costs are either normal recurring costs or that the costs are just and reasonable one-time costs in the provision of utility service to the customer. The evidence shows that Lake Region did not meet this burden.

The evidence shows Lake Region did not meet the burden to prove that the legal costs are normal recurring costs that should be included in the its yearly cost of service. In this suit, Shawnee Bend Development claimed a breach of a 1998 contract and sought damages for alleged nonpayment by Lake Region.<sup>94</sup> Utilization of the test year and true-up concept assumes that reasonable and prudent expenses included in the development of rates should be representative of costs which will be incurred each year during the period that the new rates are in effect. Legal fees incurred during the test year and true-up timeframe may be reasonable and prudent to be included in a utility's cost of service if they are costs that are reasonably calculated to be repeated. However, the evidence shows that the legal costs related to *Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer* are not recurring.<sup>95</sup> The evidence shows that Staff witness Mr. Foster agrees that these legal fees are not a normal recurring cost that would otherwise be included in rates indefinitely.<sup>96</sup> In fact, the evidence shows Lake Region itself admits there are no similar legal actions currently outstanding and none are foreseen in the near future.<sup>97</sup> So, the evidence shows that all parties agree that the Shawnee Bend Development

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<sup>94</sup> Tr. Pg. 102.

<sup>95</sup> OPC Exhibit #6.

<sup>96</sup> Staff Exhibit #12.

<sup>97</sup> Tr. Pg. 344.

breach of contract legal costs are not a recurring cost and therefore, should not be included in rates as a normal yearly cost of service item.

The evidence also shows that Lake Region did not meet its burden to prove that the legal fees are just and reasonable one-time costs in the provision of utility service to the customer. In order to include one-time costs in rates, Lake Region had to prove that the costs were reasonable and that customers have been provided a benefit from the utility incurring these costs. While the evidence shows that the Shawnee Bend Development breach of contract suit is a one-time cost, the evidence also shows that these legal costs are not just and reasonable costs in the provision of utility service to the customer.<sup>98</sup> The Court records show, and Lake Region admits, that an Appeals Court judgment was entered on July 10, 2013, in favor of the developer not Lake Region.<sup>99</sup> Court records also show the Missouri Supreme Court upheld the judgment of the Appeals Court in favor of the developer when it subsequently denied Lake Region's Application for Transfer.<sup>100</sup> Through the judgment in favor of the developer, the Appeals Court found, and the Missouri Supreme Court apparently agreed, that Lake Region unreasonably and unlawfully breached its contract with Shawnee Bend Development.

Lake Region provided no evidence to show that the costs fighting this losing battle are just and reasonable for customers to bear in their utility rates. This suit would not have been necessary if not for the actions of Lake Region in its dealings with Shawnee Bend Development Company. Customers have absolutely no say in the utility's decision making process regarding its contracts. The ability to meet (or in this case, breach) the terms of a contract is strictly based on the actions and business decisions of the utility and its shareholders. Lake Region provided

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<sup>98</sup> Tr. Pg. 344.

<sup>99</sup> Tr. Pg. 344; *See* SD32077, *Shawnee Bend Dev. Co., LLC v. Lake Region Water & Sewer Co.*, 2013 Mo. App. LEXIS 353 (Mo. Ct. App. Mar. 25, 2013).

<sup>100</sup> *See* SC93344, *Shawnee Bend Dev. Co., LLC v. Lake Region Water & Sewer Co.*, 2013 Mo. LEXIS 68 (Mo. June 25, 2013).

no evidence to the contrary. Therefore, it is just and reasonable that Lake Region and its shareholders bear the risks and the costs of these actions and decisions, not the customers.

Costs related to a construction contract breach also have no connection to the utility service rendered to customers. The customers received no benefit from this legal action so it is not just and reasonable to make customers pay these costs. It would be a slippery slope and against public policy for the Commission to order the customers to clean up after unreasonable and unlawful decisions by the utility. Any such order by the Commission in this case would clearly be detrimental to all utility customers in Missouri. Allowing these legal costs in rates would provide a disincentive for a utility to meet its contractual agreements under the reasoning that its legal costs would be borne by the customers not the utility. Also, it is reasonable to assume that riskier business decisions by the utility and its shareholders may be implemented if someone else is footing the bill, no matter the consequences. Again, Lake Region provided no evidence to the contrary. Therefore, it is just and reasonable that Lake Region and its shareholders bear the risks and the costs of these actions and business decisions, not the customers.

In order for these legal costs to be included in rates, Lake Region had the burden to prove that the costs were either normal, recurring costs or that the costs were just and reasonable one-time costs in the provision of utility service to the customer. The evidence shows that all parties agree that the Shawnee Bend Development breach of contract legal costs are not a recurring cost and therefore, should not be included in rates as a normal yearly cost of service item. Additionally, Lake Region did not meet its burden to prove that these legal costs are just and reasonable one-time costs in the provision of utility service to the customer. The evidence also shows the Appeals Court found, and the Missouri Supreme Court agreed, that Lake Region

unreasonably and unlawfully breached its contract with Shawnee Bend Development. It is not reasonable to expect customers to pay these legal costs. Therefore, the Commission should find that the legal fees for *Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer* are a non-recurring, unreasonable expense which should not be included in the calculation of rates for Lake Region.

**b. If so, what is the appropriate mechanism for recovery of these costs?**

As it is Public Counsel's position that the test year and true-up legal fees should not be recovered in rates, Public Counsel did not state a specific position on this question prior to the hearing. However, Public Counsel reserved the right to express a final position on this question based on the testimony provided at the hearing.

It is Staff's position that, as these legal fees are not a normal recurring cost, a five-year amortization with a tracker to prevent over-recovery is the appropriate mechanism to recover these expenses. It is also Lake Region's position that the legal fees should be recovered through a five-year amortization with a tracker mechanism.

Given the positions of Staff and Lake Region on this question and the evidence presented, all parties are in agreement that the legal fees incurred during the test year and true-up timeframe for *Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer* breach of contract suit are of an extraordinary nature and nonrecurring. However, if the Commission determines that Lake Region met its burden to prove that these legal costs are just and reasonable one-time costs in the provision of utility service to the customer, the evidence shows it would be just and reasonable for the Commission to determine that a five-year

amortization with a tracker to prevent over-recovery is the appropriate mechanism to recover these expenses.<sup>101</sup>

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

**/s/ Christina L. Baker**

By:\_\_\_\_\_

Christina L. Baker (#58303)

Deputy Public Counsel

P O Box 2230

Jefferson City, MO 65102

(573) 751-5565

(573) 751-5562 FAX

christina.baker@ded.mo.gov

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<sup>101</sup> Staff Exhibit #12.



**CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 21<sup>st</sup> day of March 2014:

General Counsel Office  
Missouri Public Service Commission  
200 Madison Street, Suite 800  
P.O. Box 360  
Jefferson City, MO 65102  
staffcounservice@psc.mo.gov

Kevin Thompson  
General Counsel Office  
Missouri Public Service Commission  
200 Madison Street, Suite 800  
P.O. Box 360  
Jefferson City, MO 65102  
Kevin.Thompson@psc.mo.gov

Lake Region Water and Sewer Co.  
Mark Comley  
P.O. Box 537  
601 Monroe Street, Suite 301  
Jefferson City, MO 65102-0537  
comleym@ncrpc.com

/s/ **Christina L. Baker**

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