BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Water Rate Request of	)	
Hillcrest Utility Operating Company, Inc.	)	**File No. WR-2016-0064 et al.**

REPORT AND ORDER

Issue Date: July 12, 2016

Effective Date: August 11, 2016

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REPORT AND ORDER

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APPEARANCES

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SENIOR REGULATORY LAW JUDGE: Michael Bushmann

REPORT AND ORDER

I. Procedural History

A. Case Filing and Consolidation

On September 15, 2015, Hillcrest Utility Operating Company, Inc. ("Hillcrest") filed a letter with the Missouri Public Service Commission ("Commission") requesting that the Commission approve increases in its annual water and sewer operating revenues, which resulted in the Commission opening two cases, File Nos. WR-2016-0064 and SR-2016-0065. The case was initiated under Commission Rule 4 CSR 240-3.050, which describes the procedures by which small utilities, such as Hillcrest, may request increases in their overall annual operating revenues. On October 9, 2015, the Commission's Staff filed a *Motion to Consolidate*, which requested that the Commission consolidate the two cases in the interests of administrative efficiency and economy of resources. The Commission granted the motion, consolidating both cases under File No. WR-2016-0064.

B. Test Period

The test period is a central component in the ratemaking process. Rates are usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.[1] From these four factors is calculated the "revenue requirement," which, in the context of rate setting, is the amount of revenue ratepayers must generate to pay the costs of producing the utility service they receive while yielding a reasonable rate of return to the

[1] *State ex rel. Union Electric Company v. Public Service Comm'n*, 765 S.W.2d 618, 622 (Mo. App. 1988).

investors.[2] A historical test year is used because the past expenses of a utility can be used as a basis for determining what rate is reasonable to be charged in the future.[3] Because Hillcrest's parent company acquired the water and sewer system in March 2015, Staff used a test period in this case of the four months ending July 31, 2015, with an update period through October 31, 2015, to annualize the available Hillcrest revenue and expense information and develop its revenue requirement recommendation in this case.

C. Local Public Hearing

On February 18, 2016, the Office of the Public Counsel requested that the Commission schedule a local public hearing to give Hillcrest's customers an opportunity to respond to the requested rate increase. The Commission conducted a local public hearing in Cape Girardeau, Missouri, on March 9, 2016.[4]

D. Disposition Agreements

On March 25, 2016, the Commission's Staff and Hillcrest filed *Company/Staff Partial Agreement Regarding Disposition of Small Water Company Revenue Increase Request* and *Company/Staff Partial Agreement Regarding Disposition of Small Sewer Company Revenue Increase Request*, including various attachments related to the disposition agreements (collectively, the "Agreement"). The Agreement was a partial resolution of Hillcrest's water and sewer rate requests but left unresolved certain other issues for which Staff and Hillcrest requested an evidentiary hearing. The Office of the Public Counsel objected to the Agreement, so the Agreement became a joint position statement of the

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[2] *State ex rel. Capital City Water Co. v. Public Service Comm'n*, 850 S.W.2d 903, 916 n. 1 (Mo. App. 1993).
[3] *See, State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Comm'n*, 585 S.W.2d 41, 59 (Mo. banc 1979).
[4] Transcript, Vol 1.

signatory parties, and all the issues addressed in the Agreement remained for determination after hearing.[5]

E. Evidentiary Hearing

The evidentiary hearing was held on May 19, 2016.[6] During the hearing, the parties presented evidence relating to the unresolved issues previously identified by the parties.

F. Case Submission

During the evidentiary hearing held at the Commission's offices in Jefferson City, Missouri, the Commission admitted the testimony of eight witnesses and received twenty-seven exhibits into evidence. Post-hearing briefs were filed according to the post-hearing procedural schedule. The final post-hearing briefs were filed on June 15, 2016, and the case was deemed submitted for the Commission's decision on that date.[7]

II. General Matters

A. General Findings of Fact

1. Hillcrest Utility Operating Company, Inc. ("Hillcrest"), which holds the utility assets, is wholly owned by Hillcrest Utility Holding Company, Inc., which is wholly owned by First Round CSWR, LLC, which is managed by Central States Water Resources, Inc.[8] Hillcrest provides water and sewer service to approximately 218 residential customers, twenty apartment customers, and four commercial customers located in Cape Girardeau County, Missouri.[9]

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[5] Commission Rule 4 CSR 240-2.115(2)(D).
[6] Transcript, Vols. 2 and 3.
[7] "The record of a case shall stand submitted for consideration by the commission after the recording of all evidence or, if applicable, after the filing of briefs or the presentation of oral argument." Commission Rule 4 CSR 240-2.150(1).
[8] Staff Ex. 6, Griffin Rebuttal, p. 8.
[9] Hillcrest Ex. 1, Cox Direct, p. 4.

2. The Office of the Public Counsel ("Public Counsel") is a party to this case pursuant to Section 386.710(2), RSMo[10], and by Commission Rule 4 CSR 240-2.010(10).

3. The Staff of the Missouri Public Service Commission ("Staff") is a party to this case pursuant to Section 386.071, RSMo, and Commission Rule 4 CSR 240-2.010(10).

4. In File No. WO-2014-0340, Hillcrest applied to the Commission for approval to acquire its water and sewer systems from Brandco Investments, LLC ("Brandco"). Hillcrest sought permission to acquire the water and sewer assets and to issue indebtedness and encumber those assets in order to fund the construction necessary to bring the systems into regulatory compliance. The Commission issued an order in that case on October 22, 2014, that approved a stipulation and agreement, which provided that Hillcrest should be authorized to acquire and operate the water and sewer systems owned by Brandco and imposed certain other financial conditions. Hillcrest closed on the transaction with Brandco on March 13, 2015.[11]

5. The water and sewer systems were in a complete state of disrepair when Hillcrest acquired the utility assets of Brandco.[12]

6. Since May 2014, the Hillcrest subdivision wastewater treatment plant had been under multiple compliance and enforcement actions from both the Missouri Department of Natural Resources ("MDNR") and the Missouri Attorney General. Many years of general plant neglect and lack of investment by Brandco resulted in numerous MDNR citations for discharging wastewater directly into a creek without treatment during rain events, failing to disinfect sanitary sewer waste before discharging it into the adjoining

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[10] Unless otherwise stated, all statutory citations are to the Revised Statutes of Missouri, as codified in the year 2000 and subsequently revised or supplemented.
[11] Hillcrest Ex. 1, Cox Direct, p. 7-8.
[12] Hillcrest Ex. 1, Cox Direct, p. 8.

stream, and failing to treat waste for nutrient removal before discharge. In addition, the existing lagoon berm system was in significant danger of structural failure due to slope erosion and a lack of maintenance with the slope vegetation.[13]

7. MDNR issued citations for numerous regulatory violations for the Brandco drinking water system in the Hillcrest subdivision. Beginning in May 2014, the subdivision was put on an eight-week boil order due to positive E. coli test results in the water system.[14]

8. Before Hillcrest purchased the water and sewer systems, it entered into an agreement with MDNR that provided a means for the subdivision residents to receive water service. As part of this MDNR agreement, Hillcrest paid for emergency drinking water repairs, on-going drinking water system inspections, and a temporary chlorine disinfection system to protect subdivision residents.[15]

9. Hillcrest entered into a consent agreement with MDNR that required it to immediately make necessary improvements to the Hillcrest subdivision wastewater and drinking water systems.[16]

10. Hillcrest began construction on the drinking water and wastewater improvements approximately 30 days after it acquired those systems and completed the improvements in the fall of 2015. Hillcrest has invested approximately $1,205,000 in the improved facilities.[17]

11. The Hillcrest water and sewer systems have not had a rate increase since April 9, 1989, and the cost of service has increased dramatically since that time.[18]

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[13] Hillcrest Ex. 1, Cox Direct, p. 8-9.
[14] Hillcrest Ex. 1, Cox Direct, p. 9-10.
[15] Hillcrest Ex. 1, Cox Direct, p. 11, Schedule JC-3..
[16] Hillcrest Ex. 1, Cox Direct, p. 12, Schedule JC-3.
[17] Hillcrest Ex. 1, Cox Direct, p. 12-13.
[18] Staff Ex. 8, Harrison Direct, p. 4.

12. In its original rate request letter, Hillcrest set forth its request for an increase of $236,016 in its total annual water service operating revenues and $216,663 in its total annual sewer service operating revenues.[19]

13. Because Hillcrest's parent company acquired the water and sewer system in March 2015, Staff used a test period in this case of the four months ending July 31, 2015, with an update period through October 31, 2015, to annualize the available Hillcrest revenue and expense information and develop its revenue requirement recommendation in this case.[20]

14. On March 25, 2016, the Commission's Staff and Hillcrest filed *Company/Staff Partial Agreement Regarding Disposition of Small Water Company Revenue Increase Request* and *Company/Staff Partial Agreement Regarding Disposition of Small Sewer Company Revenue Increase Request*, including various attachments related to the disposition agreements (collectively, the "Agreement"). The Agreement was a partial resolution of Hillcrest's water and sewer rate requests but left unresolved certain other issues for which Staff and Hillcrest requested an evidentiary hearing. Since Public Counsel objected to the Agreement, it is a joint position statement, but Staff and Hillcrest urge the Commission to adopt its terms. Public Counsel only objected to the disputed issues addressed at the evidentiary hearing. The Agreement is attached hereto as Attachment A and incorporated herein by reference as if fully set forth.[21]

15. The Commission finds that any given witness' qualifications and overall credibility are not dispositive as to each and every portion of that witness' testimony. The Commission gives each item or portion of a witness' testimony individual weight based

[19] Staff Ex. 1, Bolin Direct, Schedule KKB-d2, p. 1, 7.
[20] Staff Ex. 8, Harrison Direct, p. 3.
[21] Staff Ex. 1, Bolin Direct, p. 2-3; Schedule KKB-d2.

upon the detail, depth, knowledge, expertise, and credibility demonstrated with regard to that specific testimony. Consequently, the Commission will make additional specific weight and credibility decisions throughout this order as to specific items of testimony as is necessary.[22]

16. Any finding of fact reflecting that the Commission has made a determination between conflicting evidence is indicative that the Commission attributed greater weight to that evidence and found the source of that evidence more credible and more persuasive than that of the conflicting evidence.[23]

B. General Conclusions of Law

Hillcrest is a "water corporation", a "sewer corporation", and a "public utility" as defined in Sections 386.020(59), 386.020(49), and 386.020(43), RSMo, respectively, and as such is subject to the personal jurisdiction, supervision, control and regulation of the Commission under Chapters 386 and 393 of the Missouri Revised Statutes. The Commission's subject matter jurisdiction over Hillcrest's rate increase request is established under Section 393.150, RSMo.

Sections 393.130 and 393.140, RSMo, mandate that the Commission ensure that all utilities are providing safe and adequate service and that all rates set by the Commission are just and reasonable. Section 393.150.2, RSMo, makes clear that at any hearing involving a requested rate increase the burden of proof to show the proposed increase is just and reasonable rests on the corporation seeking the rate increase. As the party

[22] Witness credibility is solely a matter for the fact-finder, "which is free to believe none, part, or all of the testimony". *State ex rel. Public Counsel v. Missouri Public Service Comm'n*, 289 S.W.3d 240, 247 (Mo. App. 2009).
[23] An administrative agency, as fact finder, also receives deference when choosing between conflicting evidence. *State ex rel. Missouri Office of Public Counsel v. Public Service Comm'n of State*, 293 S.W.3d 63, 80 (Mo. App. 2009).

requesting the rate increase, Hillcrest bears the burden of proving that its proposed rate increase is just and reasonable. In order to carry its burden of proof, Hillcrest must meet the preponderance of the evidence standard.[24] In order to meet this standard, Hillcrest must convince the Commission it is "more likely than not" that Hillcrest's proposed rate increase is just and reasonable.[25]

In determining whether the rates proposed by Hillcrest are just and reasonable, the Commission must balance the interests of the investor and the consumer.[26] In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[27]

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure

[24] *Bonney v. Environmental Engineering, Inc.*, 224 S.W.3d 109, 120 (Mo. App. 2007); *State ex rel. Amrine v. Roper*, 102 S.W.3d 541, 548 (Mo. banc 2003); *Rodriguez v. Suzuki Motor Corp.*, 936 S.W.2d 104, 110 (Mo. banc 1996), citing to, *Addington v. Texas*, 441 U.S. 418, 423, 99 S.Ct. 1804, 1808, 60 L.Ed.2d 323, 329 (1979).
[25] *Holt v. Director of Revenue, State of Mo.*, 3 S.W.3d 427, 430 (Mo. App. 1999); *McNear v. Rhoades*, 992 S.W.2d 877, 885 (Mo. App. 1999); *Rodriguez v. Suzuki Motor Corp.*, 936 S.W.2d 104, 109 -111 (Mo. banc 1996); *Wollen v. DePaul Health Center*, 828 S.W.2d 681, 685 (Mo. banc 1992).
[26] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, (1944).
[27] *Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 690 (1923).

> confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[28]

The Supreme Court has further indicated:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[29]

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

> Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.[30]

Furthermore, in quoting the United States Supreme Court in *Hope Natural Gas*, the Missouri Court of Appeals said:

> [T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' … Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts.[31]

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[28] *Bluefield,* at 692-93.
[29] *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944) (citations omitted).
[30] *Federal Power Commission v. Natural Gas Pipeline Co.* 315 U.S. 575, 586 (1942).
[31] *State ex rel. Associated Natural Gas Co. v. Public Service Commission*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).

Hillcrest and Staff signed and filed the Agreement, in which those parties reached agreement on most of the issues related to Hillcrest's rate increase requests. Public Counsel objected, but only as to the disputed issues that were addressed at the evidentiary hearing. Based on the evidence in this case, the Commission concludes that acceptance of the provisions of the Agreement on the issues contained therein, other than those issues disputed at the evidentiary hearing, is a fair and reasonable resolution of those issues. The Commission will adopt the provisions of the Agreement, other than those issues disputed at the evidentiary hearing, as stated in Attachment A to this Report and Order.

III. Disputed Issues

A. Payroll

- **What level of experience should be used to set the labor expense associated with each employee?**
- **Should the Employment Cost Index inflation rates be applied in setting such amounts?**
- **What is the appropriate number of annual work hours to include in calculating salaries for each employee?**
- **What is the appropriate hourly rate for each employee?**
- **What are the appropriate job titles to use in MERIC to compare and determine labor expense associated with Mr. Josiah Cox and Mr. Jack Chalfant?**

Findings of Fact

1. Hillcrest has no employees. Several functions related to the operation of Hillcrest are provided by three employees of First Round CSWR, LLC ("First Round") – a chief executive officer, a financial manager, and an administrative employee. A portion of the costs associated with those employees is then allocated to Hillcrest.[32]

2. The Missouri Economic Research and Information Center ("MERIC") is the research division for the Missouri Department of Economic Development. It provides

[32] Transcript, Vol. 2, p. 96; Hillcrest Ex. 1, Cox Direct, p. 14.

analysis and assistance to policymakers and the public, including studies of the state's targeted industries and economic development initiative.[33]

3. Staff developed the corporate payroll compensation for ratemaking purposes in this case by using MERIC data for the St. Louis region to compare regional base salaries to the base salary amounts sought by Hillcrest in this case for the three First Round employees.[34]

4. The MERIC system provides three levels of wage estimates for each occupation. Those levels are "entry level", "mean level", and "experienced level". The entry level is the beginning level of each occupational study and is at the lowest pay level. The mean level is the mid-range of the pay scale and is an estimate of the hourly rate, which is calculated using the varying hourly rates of a group of workers in a specific occupation. The experienced level is at the top end of the scale, which are the highest paid employees in each occupation.[35]

5. Hillcrest and Public Counsel do not disagree with the general approach of using MERIC data to establish labor costs for ratemaking purposes.[36]

6. Hillcrest requests that the Commission use MERIC salaries for purposes of establishing the revenue requirement in this case corresponding to Experience Chief Executive for Mr. Josiah Cox, Experience Financial Manager for Mr. Jack Chalfant, and Experience Executive Administrative for Ms. Brenda Eaves, updated and adjusted for

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[33] Staff Ex. 8, Harrison Direct, p. 5.
[34] Staff Ex. 8, Harrison Direct, p. 5.
[35] Staff Ex. 8, Harrison Direct, p. 5-6.
[36] Hillcrest Ex. 1, Cox Direct, p. 15; OPC Ex. 1, Roth Direct, p. 6.

inflation to the most recent reporting period of the Employment Cost Index for the U.S. Bureau of Labor Statistics.[37]

7. In determining the annual amount of payroll for the three employees, Staff used the mean level of the MERIC occupational study to annualize the payroll. At the time Staff developed the cost of service for Hillcrest, all three First Round employees had a year of experience or less operating and running a regulated utility, and the company was just beginning to establish itself as a regulated utility.[38]

8. All three employees had significant work experience in their respective fields before starting work with First Round.[39]

9. Understanding the uniform system of accounts for managing a utility is radically different than Generally Accepted Accounting Principles, and understanding the tariffs associated with a regulated utility requires a specialized level of knowledge.[40]

10. The data that Staff used for MERIC was taken from calendar year 2014. At the end of the update period in this case, this data was less than one year old.[41]

11. Hillcrest's parent company has already acquired three water and sewer systems and is planning to purchase more troubled systems, which will require the hiring of more employees to maintain the operations of Hillcrest and the other acquired utilities.[42]

12. Staff was unable to calculate the number of annual work hours in determining the appropriate salaries for Mr. Chalfant and Ms. Eaves because they did not keep timesheets prior to November 2015.[43] Staff determined annual hours for Mr. Cox based on

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[37] Hillcrest Ex. 1, Cox Direct, p. 17-18.
[38] Staff Ex. 8, Harrison Direct, p. 6; Transcript, Vol. 2, p. 96.
[39] Hillcrest Ex. 1, Cox Direct, p. 16-17.
[40] Transcript, Vol. 2, p. 95-96.
[41] Staff Ex. 9, Harrison Rebuttal, p. 4.
[42] Staff Ex. 9, Harrison Rebuttal, p. 2.
[43] Hillcrest Ex. 2, Cox Rebuttal, p. 13.

his timesheets, but Staff did not include those hours worked prior to the acquisition date of March 13, 2015, in annualized payroll expense. Those hours prior to March 13, 2015, were capitalized into plant in service and included as part of Hillcrest's rate base.[44]

13. Hillcrest uses the titles of President and Chief Financial Officer for Mr. Cox and Mr. Chalfant, respectively.[45]

Conclusions of Law and Decision

The Commission finds that Staff's approach to resolving all the payroll issues is the most reasonable. It was appropriate for Staff to select the "mean" experience level in using the MERIC data to establish labor expenses for each employee. Those employees have significant prior professional experience, so they should not be categorized as "entry." However, Mr. Cox admitted at the hearing that a utility's uniform system of accounts and regulated utility tariffs require specialized understanding beyond general business practices. Since all three employees had a year or less in working for a regulated utility, the "experienced" level is also not appropriate.

The Employment Cost Index inflation rates should not be applied in setting the labor costs in this case. The data that Staff used for MERIC was taken from calendar year 2014, so at the end of the update period in this case the data was less than one year old. Adjusting salaries for inflation is not necessary, and granting this unusual treatment would further increase rates, with little justification, that are already increasing significantly. In calculating salaries for each employee, the annual work hours determined by Staff should be used for Mr. Cox, based on his timesheets. Since Mr. Chalfant and Ms. Eaves did not keep time sheets during the test period, 14% of those two employees' annualized salaries

[44] Staff Ex. 9, Harrison Rebuttal, p. 3.
[45] Hillcrest Ex. 1, Cox Direct, p. 16-17; Staff Ex. 8, Harrison Direct, p. 4-5.

should be used.[46] The appropriate hourly rate for each employee should be those rates calculated by Staff based on its positions on the above issues.

The appropriate job titles to use in MERIC to determine labor expense for Mr. Cox and Mr. Chalfant are President and Chief Financial Officer, respectively. These are the titles presently used by Hillcrest to describe those two employees, and Staff's comparison of their job duties to MERIC found that these titles should continue to be used for ratemaking purposes. Since Hillcrest is part of a group of commonly-owned regulated utilities and has plans to acquire additional utilities, it is appropriate to assign employee titles similar to larger utilities rather than single utility companies.

B. Property Taxes

- **What is the appropriate amount of property taxes to include in the Hillcrest revenue requirements?**
- **Should estimated property tax amounts be included in rates?**

<u>Findings of Fact</u>

1. Property taxes are computed using assessed property values. Utilities are required to file with the taxing authorities a valuation of their utility property at the first of each year based on the January 1 assessment date. Several months later, the taxing authorities provide the utility with what they refer to as an "assessed value" for each category of property owned. Much later in the year (typically in the fall) the utilities are given the property tax rate. Property tax bills are then issued to the utilities with due dates of December 31 for each year based on the property tax rates applied to assessed value. For

[46] 14% refers to the corporate allocation percentage the Commission determines on page 33 below to be appropriate to apply to corporate costs for Hillcrest.

example, a utility will pay property taxes on December 31, 2015, based upon an assessment made of its asset values as of January 1, 2015.[47]

2. Staff included $164 for water and $164 for sewer in the cost of service for property tax expense, based on Hillcrest's actual taxes paid as of December 31, 2015. This amount included Hillcrest's property taxes paid to Cape Girardeau County and Hillcrest's 14% share of First Round's St. Louis County property taxes, combined and allocated equally between Hillcrest's water and sewer operations.[48]

3. The actual property taxes paid as of December 31, 2015, best matches the test period in this case, which ended October 31, 2015.[49]

4. The term "matching principle" refers to the practice that all elements of the revenue requirement, including revenues, expenses, and rate base, be measured and included in the utility's cost of service at the same general point in time. It is very important that all elements of the revenue requirement be considered at a consistent point in time because various events cause changes to a utility's revenues, expenses, and rate base amounts, individually or in combination, causing the utility's overall revenue requirement to change over time. Reflecting changes to only one element of the revenue requirement in rates, in this case property taxes, without consideration of all other possible offsetting changes in the other cost of service components, would likely lead to a distorted and inaccurate level of customer rates.[50]

5. Plant additions and improvements made by Hillcrest between April 1, 2015, and October 31, 2015, would not be assessed for property tax purposes until January 1,

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[47] Staff Ex. 11, Sarver Direct, p. 3.
[48] Staff Ex. 11, Sarver Direct, p. 4-5.
[49] Staff Ex. 11, Sarver Direct, p. 5.
[50] Staff Ex. 11, Sarver Direct, p. 6.

2016, and will not be paid until December 31, 2016, which is fourteen months beyond the update period in this case.[51]

6. Hillcrest has requested that the amount of $2,972 be included in its cost of service for property tax. This amount has not yet been paid, is an estimate of the property tax costs, and could change during the summer of 2016.[52]

Conclusions of Law and Decision

Hillcrest has proposed that estimated property taxes in the amount of $2,972 be included in its cost of service in this case. That estimated property tax will not be paid until approximately December 31, 2016, so it is beyond the test and update periods for this case. Since it occurs after the update period, to be included in Hillcrest's cost of service the expense must have been realized (known) and must be calculable with a high degree of accuracy (measurable).[53] However, the evidence shows that the 2016 property tax amount has not yet been paid, is an estimate of the property tax costs, and could change during the summer of 2016. Therefore, that property tax estimate is not known and measurable, so it is inappropriate to include that amount in the revenue requirement for this case. The correct property tax expenses to include in Hillcrest's cost of service are the amounts determined by Staff based on actual property tax paid in 2015, as those amounts are consistent with the matching principle.

In its initial brief, Hillcrest requested for the first time in this case that if it does not receive the $2,972 in its revenue requirement, the Commission should authorize a refundable surcharge or a tracker for property taxes. Since this request was first submitted

[51] Staff Ex. 11, Sarver Direct, p. 6.
[52] Hillcrest Ex. 2, Cox Rebuttal, p. 20-21; Staff Ex. 11, Sarver Direct, p. 5.
[53] *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service*, ER-2014-0370, 2015 WL 5244724, at *71 (Sept. 2, 2015). *State ex rel. GTE North, Inc. v. Missouri Public Service Commission,* 835 S.W. 2d 356, 368 (Mo App. 1992).

in a brief, it violates Commission Rule 4 CSR 240-2.130(7)(A), which requires that "[d]irect testimony shall include all testimony and exhibits asserting and explaining that party's entire case-in-chief." By submitting the request for the first time after the close of evidence, Hillcrest has prevented other parties from having a sufficient opportunity to conduct discovery or provide testimony on that matter. In addition, a tracker is a type of deferral accounting to defer costs which may be incurred in the future for "extraordinary items," as defined in the Uniform System of Accounts.[54] The Commission concludes that Hillcrest has not met its burden of proof to demonstrate that projected property taxes are extraordinary. For all these reasons, the Commission concludes that Hillcrest's request for a refundable surcharge or a tracker should be denied. Hillcrest's 2016 property tax may be eligible for inclusion in its cost of service in a future rate case.

[54] "Those items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence shall be considered extraordinary items. Accordingly, they will be events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the foreseeable future." 18 C.F.R. § Pt. 101, General Instruction No. 7; See also, Report and Order, ER-2012-0174, *In the Matter of Kansas City Power & Light Company's Request for Auth. to Implement A Gen. Rate Increase for Elec. Serv. & in the Matter of KCP&L Greater Missouri Operations Company's Request for Auth. to Implement A Gen. Rate Increase for Elec. Serv.*, 2013 WL 299322 (Jan. 9, 2013); Report and Order, *In the Matter of the Application of S. Union Co. for the Issuance of an Accounting Auth. Order Relating to Its Natural Gas Operations & for A Contingent Waiver of the Notice Requirement of 4 CSR 240-4.020(2)*, GU-2011-0392, 2012 WL 363727 (Jan. 25, 2012).

C. Auditing and Income Tax Preparation Fees

- **What is the appropriate amount of Hillcrest's auditing and tax preparation (accounting) costs to include in Hillcrest's cost of service?**
- **What is the appropriate allocated level of auditing and tax preparation (accounting) costs for Central States Water Resources to include in Hillcrest's cost of service?**
- **Should accounting costs incurred and paid in 2016 by Hillcrest be included in Hillcrest's cost of service?**

Findings of Fact

1. Hillcrest issued requests for proposals to a variety of accountants and accounting firms in order to determine the least expensive qualified firm for auditing and tax preparation services for Hillcrest and its parent company. Hillcrest hired the firm with the lowest qualified costs. Hillcrest is requesting that its share of those bid amounts be included in its revenue requirement in this case.[55]

2. The bid that Hillcrest received for auditing and tax preparation services is only an estimate of the expected cost of those services.[56] Those fees have not yet been paid.[57]

3. Staff determined costs for auditing and tax preparation services by using actual costs of the parent company in 2015 and allocating 14% of that amount to Hillcrest.[58] Staff calculated that Hillcrest's share of the costs was approximately $326, divided equally between water and sewer operations.[59]

Conclusions of Law and Decision

Hillcrest requests that an estimate of its auditing and tax preparation fees to be paid in 2016 be included in the revenue requirement for this case. Those costs would occur

[55] Hillcrest Ex. 1, Cox Direct, p. 20-21.
[56] Staff Ex. 8, Harrison Direct, p. 9.
[57] Transcript, Vol. 2, p. 98.
[58] 14% refers to the corporate allocation percentage the Commission determines on page 33 below to be appropriate to apply to corporate costs for Hillcrest.
[59] Staff Ex. 8, Harrison Direct, p. 8-9.

outside of the test and update periods, which would violate the matching principle. Hillcrest has not met its burden of proof to demonstrate that the costs are both known and measurable, as the evidence shows they have not yet been paid and are only an estimate of those costs. The Commission concludes that any accounting costs incurred and paid in 2016 by Hillcrest should not be included in Hillcrest's cost of service for this case. The appropriate amount of auditing and tax preparation costs to include in Hillcrest's cost of service is the allocated amount of $326, divided equally between water and sewer operations, as determined by Staff to have actually been paid in 2015.

D. Rate of Return

- **What is the appropriate capital structure for purposes of setting Hillcrest's allowed rate of return?**
- **What is the appropriate allowed return on equity to apply to the equity in the ratemaking capital structure?**
- **What is the appropriate allowed debt rate to apply to the debt in the ratemaking capital structure?**

Findings of Fact

1. An essential ingredient of the cost-of-service ratemaking formula is the rate of return, which is premised on the goal of allowing a utility the opportunity to recover the costs required to secure debt and equity financing. If the allowed rate of return is based on the costs to acquire capital, then it is synonymous with the utility's weighted average cost of capital, which is calculated by multiplying each component ratio of the appropriate capital structure by its cost and then summing the results. In order to arrive at a rate of return, the Commission must examine an appropriate ratemaking capital structure, Hillcrest's cost of debt, and Hillcrest's cost of common equity, or return on equity.[60]

[60] Staff Ex. 4, Griffin Direct, Schedule SG-d2, p. 6-8.

2. As of September 2015, Hillcrest's actual capital structure was 19% equity and 81% debt.[61]

3. Staff recommended a hypothetical capital structure for Hillcrest consisting of 25% equity and 75% debt.[62]

4. Staff calculated a return on equity ("ROE") for Hillcrest by taking the projected yield on long-term public utility bonds that would be assigned to a three-month average of debt with a B rating and adding a 4% risk premium to that amount. Taking into consideration the change in spread for corporate bond yields in the early part of 2016, Staff determined an appropriate ROE range of 12.88% to 14.13% for Hillcrest.[63]

5. Hillcrest agrees that the ROE range determined by Staff is reasonable.[64] Public Counsel did not take a position on an appropriate ROE.

6. Mr. Cox testified credibly that prior to filing the first asset acquisition and financing case with the Commission, he met with over fifty specialized infrastructure institutional investors, private equity investors, investment bankers, and commercial banks on behalf of Hillcrest and its parent company in an attempt to create a program to build water and wastewater improvements to support distressed small water and sewer utilities in Missouri.[65] His attempts to secure debt and equity financing from traditional lending sources were unsuccessful.[66]

7. In general, small distressed water and sewer systems are shut off from traditional capital markets because of potential liability associated with existing health and

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[61] Hillcrest Ex. 2, Cox Rebuttal, p. 21; Transcript, Vol. 2, p. 44.
[62] Staff Ex. 4, Griffin Direct, p. 2.
[63] Staff Ex. 4, Griffin Direct, p. 7-9.
[64] Hillcrest Ex. 2, Cox Rebuttal, p. 21-22.
[65] Hillcrest Ex. 1, Cox Direct, p. 24; Transcript, Vol. 2, p. 51.
[66] Hillcrest Ex. 1, Cox Direct, p. 27.

environmental compliance failures, lack of professional management, and a complex regulatory system.[67]

8. Mr. Cox testified credibly that the best deal he could obtain to finance the necessary improvements to the Hillcrest water and sewer systems was a financing agreement dated March 6, 2015, with Fresh Start Venture LLC ("Fresh Start") at an interest rate of 14%.[68]

9. Fresh Start was originally formed in 2014 by a group of 12 equity investors and created specifically to provide financing for this investment opportunity pursuant to a contractual agreement.[69] In 2014, Fresh Start obtained a 33% ownership interest in First Round and a financing agreement at an interest rate of 14%.[70]

10. At some time prior to March 6, 2015, two new investors ("New Investors") acquired 87% of the membership interest of First Round and all of Fresh Start.[71]

11. Staff recommended a cost of debt for Hillcrest within the range of 8.88% to 10.13%.[72] Staff determined this proposed range by estimating a cost of debt based on junk bond debt yields from published indices that Staff believes would satisfy a hypothetical third-party debt investor's market requirements.[73]

12. Staff recommends a hypothetical cost of debt much lower than Hillcrest's actual debt cost with Fresh Start because Staff does not know how the 14% debt cost was determined and suspects that the debt cost did not result from arms-length good faith

[67] Hillcrest Ex. 1, Cox Direct, p. 25-26.
[68] Transcript, Vol. 2, p. 114; Staff Ex. 4, Griffin Direct, p. 4; Staff Ex. 14.
[69] Staff Ex. 6, Griffin Rebuttal, p. 10.
[70] Staff Ex. 6, Griffin Rebuttal, p. 9.
[71] Staff Ex. 6, Griffin Rebuttal, p. 9; Staff Ex. 13, p. 2; Staff Ex. 14, p. 28 and signature page.
[72] Staff Ex. 4, Griffin Direct, p. 4.
[73] Staff Ex. 4, Griffin Direct, p. 4-7; Staff Ex. 6, Griffin Rebuttal, p. 5.

negotiations.[74] Staff is concerned about accepting 14% as a market-based cost of debt because it views the investment structure of Hillcrest and associated entities as complex, not transparent, and consisting of non-traditional affiliations between investors.[75] However, Staff has not alleged that Hillcrest's debt is imprudent.[76]

13. The Fresh Start loan agreement specifically prohibits Hillcrest from issuing any additional debt, and the make whole premiums for any potential early retirement of the Fresh Start debt make it uneconomical to do so.[77]

14. Public Counsel did not take a formal position on the appropriate cost of debt for Hillcrest.[78]

Conclusions of Law and Decision

Capital structure

In determining the rate of return, the Commission must first consider Hillcrest's capital structure. The Commission concludes that in calculating Hillcrest's cost of capital and cost of debt, the appropriate capital structure to use is the actual capital structure of Hillcrest as of September 2015, which was 19% equity and 81% debt. In order to set a fair rate of return for Hillcrest, the Commission must determine the weighted cost of each component of the utility's capital structure.

[74] Staff Ex. 6, Griffin Rebuttal, p. 4.
[75] Staff Ex. 6, Griffin Rebuttal, p. 13.
[76] Transcript, Vol. 2, p. 178.
[77] Staff Ex. 6, Griffin Rebuttal, p. 15; Staff Ex. 14, p. 21, section 6.15.
[78] Public Counsel argues that Mr. Cox's testimony should not be believed regarding his efforts to secure financing. Public Counsel alleges that Mr. Cox improperly failed to disclose certain information to creditors in a previous personal bankruptcy proceeding. The Commission does not have the authority or expertise to make a legal conclusion about whether Mr. Cox violated bankruptcy laws, so declines to rely on that allegation in evaluating Mr. Cox's credibility.

Return on equity

One component at issue in this case is the estimated cost of common equity, or the return on equity. Estimating the cost of common equity capital is a difficult task, as academic commentators have recognized.[79] Determining a rate of return on equity is imprecise and involves balancing a utility's need to compensate investors against its need to keep prices low for consumers.[80] Missouri court decisions recognize that the Commission has flexibility in fixing the rate of return, subject to existing economic conditions.[81] "The cases also recognize that the fixing of rates is a matter largely of prophecy and because of this commissions, in carrying out their functions, necessarily deal in what are called 'zones of reasonableness', the result of which is that they have some latitude in exercising this most difficult function."[82] Moreover, the United States Supreme Court has instructed the judiciary not to interfere when the Commission's rate is within the zone of reasonableness.[83]

The evidence shows that both Hillcrest and Staff agree that an ROE within the range of 12.88% to 14.13% would be a reasonable and accurate estimate of the current market cost of capital for Hillcrest. Based on the competent and substantial evidence in the record and on its balancing of the interests of the company's ratepayers and shareholders, the Commission concludes that 13.0% is a fair and reasonable return on equity for Hillcrest.

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[79] See Phillips, *The Regulation of Public Utilities*, Public Utilities Reports, Inc., p. 394 (1993).
[80] *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 574 (Mo. Ct. App. 2009).
[81] *State ex rel. Laclede Gas Co. v. Public Service Commission*, 535 S.W.2d 561, 570-571 (Mo. App. 1976).
[82] *Id.* In fact, for a court to find that the present rate results in confiscation of the company's private property, that court would have to make a finding based on evidence that the present rate is outside of the zone of reasonableness, and that its effects would be such that the company would suffer financial disarray. *Id.*
[83] *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 574 (Mo. App. 2009). *See, In re Permian Basin Area Rate Cases,* 390 U.S. 747, 767, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968) ("courts are without authority to set aside any rate selected by the Commission [that] is within a 'zone of reasonableness' ").

Cost of debt

The other component of Hillcrest's capital structure in dispute in this case is the appropriate cost of debt. Hillcrest requests that the Commission utilize the debt cost of 14%, which is the actual interest rate Hillcrest is obligated to pay to Fresh Start under their financing agreement. Staff urges the Commission to reject the actual cost of debt and instead impute a hypothetical cost of debt to Hillcrest's capital structure. Staff is concerned about accepting 14% as a market-based cost of debt because it views the investment structure of Hillcrest and its associated entities as complex, not transparent, and consisting of non-traditional affiliations between investors. Staff recommends a hypothetical cost of debt much lower than Hillcrest's actual debt cost with Fresh Start because Staff does not know how the 14% debt cost was determined and suspects that the debt cost did not result from arms-length good faith negotiations. In addition, Staff alleges that Hillcrest has failed to sufficiently demonstrate that it sought the least-cost option available to it when obtaining financing, which was a condition in the stipulation and agreement signed by Hillcrest and approved by the Commission in Hillcrest's asset acquisition proceeding in File No. WO-2014-0340.

The Commission has the legal authority to impose for ratemaking purposes a lower cost of debt than a utility's actual debt cost.[84] However, Staff's arguments are not persuasive that a hypothetical debt cost should be imposed on Hillcrest in this case. Staff expressed suspicions that the financing agreement with Fresh Start was not an arms-length transaction but did not present sufficient evidence to support that allegation. The interest rate under the financing agreement did not change when the New Investors took over

[84] *State ex rel. U.S. Water/Lexington v. Missouri Public Service Commission*, 795 S.W.2d 593, 597 (Mo. App. 1990).

Fresh Start and acquired the majority ownership interest in First Round, but there is not enough information in the record concerning the circumstances surrounding that transaction to reach the conclusion that the transaction was not in good faith. While the Commission expects Hillcrest to be responsive to Staff's appropriate requests for information, the company should not be penalized because it chooses to utilize a complex or non-traditional investment structure for its own business purposes. With regard to Hillcrest's compliance with the condition in the stipulation and agreement in File No. WO-2014-0340, Staff did not present evidence that Hillcrest failed to seek a lower-cost financing arrangement. On the contrary, Mr. Cox testified credibly that he made significant efforts, although unsuccessful, to obtain financing from more traditional commercial banks and financial institutions. The Commission concludes that Hillcrest has met its burden of proof to demonstrate that it sought the least-cost financing option available to it.

The Commission is very concerned about the effect dramatically increasing water and sewer rates will have on Hillcrest's customers. However, as stated in the *Bluefield* Supreme Court case, in setting just and reasonable rates the Commission must provide a return to the utility that is "reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties".[85] It is important that utility companies be able to attract sufficient capital to meet their financial obligations and provide adequate service to their customers. Hillcrest acquired these systems when they were in a complete state of disrepair, and the company had to find funds to immediately make necessary improvements to protect the health of its customers and to satisfy MDNR and the Missouri

[85] *Bluefield,* at 692-93.

Attorney General. The evidence shows that after diligent efforts to obtain financing from a variety of potential lenders, the only financing available to Hillcrest at that time was the transaction with Fresh Start. Penalizing Hillcrest now for that decision would be unfair and may discourage other companies from acquiring and improving troubled water and sewer utilities in the future, which would be contrary to good public policy. The Commission concludes that the appropriate allowed debt rate to apply to the debt in the ratemaking capital structure is the actual debt cost of 14%.

E. Rate Design

- **How many classes should Hillcrest's customers be divided into for the purposes of designing rates for both water and sewer?**
- **What are the proper allocation percentages to be used to allocate expenses between the customer charge and volumetric rate?**
- **Should a rate increase be implemented all at once or phased-in over time?**

Findings of Fact

1. Hillcrest provides water and sewer service to residential, apartment, and commercial customers.[86] Currently, Hillcrest's sewer customers are divided into two rate classes, one for residential and commercial with a flat monthly customer charge of $14.63 and another for apartments with a flat monthly charge of $11.70. Its water customers currently have only one rate class with a customer charge of $3.58 per month and a commodity fee of $1.84 per 1,000 gallons used.[87] These rates have been unchanged since 1989.[88]

[86] OPC Ex. 5, Russo Direct, p. 3-4.
[87] Staff Ex. 2, Robertson Direct, p. 6-7.
[88] Hillcrest Ex. 1, Cox Direct, p. 13.

2. Public Counsel has proposed to change Hillcrest's rate design by creating three customer classifications for water and sewer service – residential, apartment, and commercial classes.[89] Hillcrest and Staff do not object to this proposal.[90]

3. The customer charge is the amount charged to customers each month regardless of the amount of water used. The monthly minimum customer charge includes the costs that remain relatively constant throughout the course of the year, including operating expenses and capital costs not directly associated with the production of water.[91]

4. The volumetric rate is the rate charged to customers based on the amount of water used by the customer at specifically-set intervals. The volumetric rate includes the operating and capital costs related to the production of water.[92]

5. Public Counsel's witness James Russo testified credibly regarding the proper allocation percentages to be used to allocate expenses between the customer charge and volumetric rate for water service. Under Public Counsel's rate design, all costs are assigned directly as a customer charge or a volumetric rate or, alternatively, a representative portion of the costs are allocated by a percentage to either the customer charge or the volumetric rate based on the particular characteristics of the cost.[93] Neither Hillcrest nor Staff provided evidence in the record of the hearing regarding how expenses should be assigned between the fixed customer charge and volumetric rate.

6. The water and sewer rates for Hillcrest customers will be raised dramatically under the proposals offered by the parties in this case.[94]

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[89] OPC Ex. 5, Russo Direct, p. 6.
[90] Hillcrest Ex. 2, Cox Rebuttal, p. 2; Staff Ex. 3, Robertson Rebuttal, p. 4.
[91] OPC Ex. 5, Russo Direct, p. 5.
[92] OPC Ex. 5, Russo Direct, p. 5.
[93] OPC Ex. 5, Russo Direct, p. 6-8 and included Schedules.
[94] OPC Ex. 5, Russo Direct, p. 12-14.

7. Both Staff and Public Counsel have proposed alternative rate design plans to phase-in increased utility rates over a period of time in an effort to mitigate the rate shock attributed to high rates.[95]

8. The rate phase-in plans would not provide Hillcrest with sufficient cash to pay its operations costs and would cause Hillcrest to default on its debt service payments in the first year of operations under the new rate.[96]

9. Under the rate phase-in proposals, the carrying costs associated with the booking of those deferred revenues means that, in the end, the customers would pay more out of their pockets than they would in the absence of a phase-in, all else being equal.[97]

Conclusions of Law and Decision

Public Counsel has proposed to change Hillcrest's rate design by creating three customer classifications for water and sewer service – residential, apartment, and commercial classes, and Hillcrest and Staff do not object to this proposal. The Commission agrees that the rate design should be changed to include the three customer classifications as proposed.

Public Counsel's witness James Russo provided the only evidence regarding the proper allocation percentages to be used to allocate expenses between the customer charge and volumetric rate for water service. The Commission concludes that the proper allocation percentages and methodologies to be used for this purpose are those described in James Russo's direct testimony.

Staff and Public Counsel have both proposed alternate rate design plans that provide a rate phase-in to help mitigate rate shock for Hillcrest's ratepayers. "[T]he Public

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[95] Staff Ex. 2, Robertson Direct, p. 8-9; OPC Ex. 5, Russo Direct, p. 14-15, Schedule 12.
[96] Hillcrest Ex. 2, Cox Rebuttal, p. 8-10.
[97] Hillcrest Ex. 2, Cox Rebuttal, p. 10-11.

Service Commission is a body of limited jurisdiction and has only such powers as are expressly conferred upon it by the statutes and powers reasonably incidental thereto."[98] As the Commission is an administrative agency with limited jurisdiction, "the lawfulness of its actions depends directly on whether it has statutory power and authority to act."[99] Accordingly, the Commission does not have the legal authority to order a phase-in of rates unless it has been given such authority by the General Assembly of this state. Section 393.155, RSMo, authorizes the Commission to phase-in rate increases over time under certain circumstances, but that authority is only provided with regard to electrical corporations. The statute does not give express authority for a rate phase-in for other types of utilities, such as water or sewer companies. The statutory authority for the Commission to order a rate phase-in for Hillcrest in this case is uncertain.

Moreover, the evidence shows that the rate phase-in plans would not provide Hillcrest with sufficient cash to pay its operations costs; would cause Hillcrest to default on its debt service payments in the first year of operations under the new rate, and would, in the end, cost the ratepayers more than not using a phase-in. The Commission finds that the two phase-in plans are not in the best interests of either Hillcrest or the ratepayers. The Commission concludes that any rate increase should be implemented all at once and not phased-in over time.

F. Corporate Allocation

- **What is the appropriate corporate allocation percentage to apply to corporate costs?**

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[98] *State ex rel. Kansas City Power & Light Co. v. Buzard,* 168 S.W.2d 1044, 1046 (Mo. 1943); *State ex rel. City of West Plains v. Public Service Commission,* 310 S.W.2d 925, 928 (Mo. banc 1958).
[99] *State ex rel. Gulf Transp. Co. v. Public Service Commission,* 658 S.W.2d 448, 452 (Mo. App. 1983).

Findings of Fact

1. Hillcrest has requested that the Commission allocate 14% of the corporate costs of the parent company to it for ratemaking purposes. Hillcrest's proposed allocation of 14% represents the percentage of work time the company believes will be required of its employees in the future taking into consideration the completion of additional acquisitions of water and sewer companies.[100]

2. In addition to Hillcrest, First Round owns and operates Raccoon Creek Utility Operating Company, Inc. and Indian Hills Utility Operating Company, Inc., with approximately 500 and 700 customers, respectively.[101] Based on total existing customers for the three companies that First Round currently operates, Hillcrest customers represent over 28% of the current total customer base.[102] First Round has contracts to acquire two additional water or sewer utilities.[103]

3. Staff determined a 14% corporate cost allocation factor based on the number of customers in Hillcrest compared to the number of customers in utilities acquired by First Round and utilities that are planned to be acquired.[104]

4. Public Counsel proposed a corporate cost allocation factor of 10.49% based on a review of Mr. Cox's time sheets from March 13, 2015 through October 31, 2015.[105] Public Counsel did not use the time sheets of Mr. Chalfant and Ms. Eaves in calculating an allocation factor because those two employees did not begin recording their time until after October 31, 2015.[106] If Public Counsel had taken the time sheets for operational duties of

[100] Hillcrest Ex. 1, Cox Direct, p. 15; Hillcrest Ex. 2, Cox Rebuttal, p. 13.
[101] OPC Ex. 1, Roth Direct, p. 2-3.
[102] Transcript, Vol. 2, p. 198.
[103] Transcript, Vol. 2, p. 112-113.
[104] Staff Ex. 8, Harrison Direct, p. 7.
[105] OPC Ex. 3, Roth Rebuttal, p. 2; OPC Ex. 4, Roth Rebuttal Schedule KNR-1; Hillcrest Ex. 3.
[106] OPC Ex. 3, Roth Rebuttal, p. 2.

those two employees recorded after October 31, 2015 into consideration, the Hillcrest allocation percentage would be closer to 21%.[107]

5. When Public Counsel calculated its allocation factor by using Mr. Cox's time sheets, it only used those hours found in the "HC," or Hillcrest, column to determine work associated with Hillcrest and considered all other hours as "non-regulated."[108]

6. Mr. Cox testified credibly that on his time sheets, regulated work related to Hillcrest is also included in columns besides the "HC" column used by Public Counsel to calculate an allocation factor.[109]

Conclusions of Law and Decision

Of the three methods proposed for calculating the corporate cost allocation factor, the Commission finds that Staff's method is the most reliable and reasonable. Hillcrest did not present sufficient evidence of how it determined its allocation factor based on employee time sheets. Public Counsel's proposed allocation factor is unreasonably low because it completely disregarded the work time of Mr. Chalfant and Ms. Eaves and only included a portion of Mr. Cox's work time related to Hillcrest.

Public Counsel's criticism of Staff's method as being based on estimated, future costs, and not known and measurable, is not applicable in this situation. The allocation factor is not an expense that occurs outside of the test year but rather a method of allocating corporate costs that occur within the test year. The Commission concludes that the appropriate corporate allocation percentage to apply to corporate costs is 14%.

[107] Hillcrest Ex. 2, Cox Rebuttal, p. 14.
[108] OPC Ex. 4, Roth Rebuttal Schedule KNR-1; Hillcrest Ex. 3.
[109] Transcript, Vol. 2, p. 132-136.

Decision Summary

In making this decision as described above, the Commission has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence but indicates rather that the material was not dispositive of this decision.

Hillcrest provides safe and adequate service, and the Commission concludes, based upon its independent review of the whole record, that the rates approved as a result of this order support the provision of safe and adequate service. The revenue increase approved by the Commission is no more than what is sufficient to keep Hillcrest's utility plants in proper repair for effective public service and provide to Hillcrest's investors an opportunity to earn a reasonable return upon funds invested.

THE COMMISSION ORDERS THAT:

1. The Commission adopts the provisions, other than those issues disputed at the evidentiary hearing, of the *Company/Staff Partial Agreement Regarding Disposition of Small Water Company Revenue Increase Request* and *Company/Staff Partial Agreement Regarding Disposition of Small Sewer Company Revenue Increase Request* filed on March 25, 2016, including attachments. The signatories are ordered to comply with the terms of these partial disposition agreements, which are attached hereto as Attachment A and incorporated herein by reference as if fully set forth.

2. Hillcrest Utility Operating Company, Inc. is authorized to file tariff sheets sufficient to recover revenues approved in compliance with this order. Hillcrest Utility Operating Company, Inc. shall file its compliance tariff sheets no later than July 20, 2016.

3. Hillcrest Utility Operating Company, Inc. shall file the information required by Section 393.275.1, RSMo 2000, and Commission Rule 4 CSR 240-10.060 no later than July 20, 2016.

4. The Staff of the Missouri Public Service Commission shall file its recommendation concerning approval of Hillcrest Utility Operating Company, Inc.'s compliance tariff sheets no later than July 27, 2016.

5. Any other party wishing to respond or comment regarding Hillcrest Utility Operating Company, Inc.'s compliance tariff sheets shall file the response or comment no later than July 27, 2016.

6. This Report and Order shall become effective on August 11, 2016.

BY THE COMMISSION

Morris L. Woodruff
Secretary

Hall, Chm., Kenney, Rupp,
and Coleman, CC., concur,
Stoll, C., dissents, with separate
dissenting opinion attached;
and certify compliance with the
provisions of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 12th day of July, 2016.