

MOUNTAIN WATER COMPANY

Before the Public Service Commission of Montana

Docket No. D2011.1.8

**Rebuttal Testimony
of
John Kappes**

*** * * * ***

1 **Q: Please state your name and business address.**

2 **A:** My name is John Kappes. My business address is Mountain Water Company,
3 1345 W. Broadway, Missoula, Montana.

4 **Q: What is your position with Mountain Water Company:**

5 **A:** I am the Co-CEO of Mountain Water Company.

6 **Q: What are your qualifications, in terms of education and experience, for**
7 **appearing as a witness in this proceeding:**

8 **A:** I graduated May of 1994 from the University of Montana with a Bachelor of Science
9 Degree in Business, with an emphasis in accounting. I passed the CPA exam
10 November 1994, and received my Certified Public Accountant license for the state of
11 Montana April of 1997. In April of 1995, I attended the NARUC Utility Rate Seminar
12 co-sponsored by Florida State University.

13 I have worked for Mountain since November 14, 1990 in various capacities. I
14 became the Assistant General Manager in 2001. I have held my current position as
15 Co-CEO since September 2010. I worked as the Coordinator of Rates from 1994
16 until 2001. I was involved in the preparation of the general rate applications for the

1 Missoula Division, Docket No. 94.7.26, and for the Superior Division, Docket No.
2 94.10.46. I prepared and was a witness in the three general rate applications for
3 Missoula Division, Docket Nos. 96.4.61, 98.5.104 and 2000.7.112, as well as the
4 Superior Division general rate application, Docket No. 96.6.97. I oversaw the
5 preparation of and was a witness for the most recent general rate applications for the
6 Missoula Division, Docket 2002.5.60, Docket D2005.4.49, Docket 2008.9.119 and
7 Docket 2010.4.41.

8 **Q. What is the purpose of your testimony?**

9 **A.** The purpose of my testimony is to address the pre-filed testimony of Mayor John
10 Engen, on behalf of the City of Missoula, Mr. Charles Rial on behalf of the Clark Fork
11 Coalition, and Dr. John Wilson on behalf of the Montana Consumer Counsel. First, I
12 will provide a general overview of this proceeding, and some contextual observations
13 that apply to the testimony of the witnesses. Second, I will present the response of
14 Mountain to the testimony of each witness. I will explain Mountain's agreement or
15 disagreement with the testimony of each witness, and the basis of that agreement or
16 disagreement. Finally, I will provide the Commission with a recommendation as to
17 how it should respond, in its final order in this docket, to the positions taken by each
18 of the three witnesses.

19 **Q. Why do you believe it is necessary to provide a general overview at this stage**
20 **of the proceedings?**

21 **A.** It is critical for the Commission to constrain its deliberations in this docket to the
22 lawful scope of its authority. This docket is not a plebiscite on the merits of public
23 versus private ownership of Mountain. The simple fact of the matter is that

1 Mountain is not owned by the City of Missoula. It is owned by Park Water Company.
2 The Commission does not sit as arbiter of whether the ownership of Mountain should
3 be transferred, now or in the future, from private to public ownership, from ownership
4 by Park to ownership by the City.

5 The only questions before this Commission relate to the sale of the stock of
6 Park Water Company from its current owners, the Wheeler family, to the Carlyle
7 Group, which has entered into an agreement with the Wheeler family to purchase
8 the stock. The desire of the Wheeler family to sell their stock in Park does not vest
9 this Commission with authority to determine that Mountain should be owned by the
10 City of Missoula instead of Park Water Company. The ownership of Mountain Water
11 Company is not at issue in this proceeding.

12 Mountain is not being sold, and is not for sale. Only a court of law, in an
13 eminent domain proceeding, has the power to determine that Mountain Water
14 Company should be owned by the City of Missoula. The City has already tried,
15 unsuccessfully, to condemn Mountain. The Montana Supreme Court soundly
16 rejected the City's attempt. The testimony of Mayor Engen, on behalf of the City of
17 Missoula, and Mr. Rial, on behalf of the Clark Fork Coalition, is misplaced, as both
18 devote their testimony to urging public ownership of Mountain.

19 **Q. What then is at issue in this proceeding?**

20 **A.** The real issues in this proceeding are defined by the scope of the Commission's
21 jurisdiction. Mountain has been regulated by the Commission since it acquired the
22 water system serving the Missoula area from the Montana Power Company in 1979.
23 I believe that Mountain has served its customers well, and has enjoyed the respect

1 of both the community it serves and this Commission. The decision of the Wheeler
2 family to sell their stock in the Park Water Company does not change the
3 relationship of Mountain to either the community it serves, or to this Commission.
4 Regardless of who owns the stock of Mountain's corporate parent, Park, Mountain's
5 status as a privately owned public utility regulated by the Commission remains
6 unchanged. The Commission's authority over the rates and service provided by
7 Mountain to the community it serves is unaffected. Similarly, the jurisdiction of the
8 Montana Department of Natural Resources and Conservation over the water rights
9 held by Mountain are unaffected by the sale of the Park Water Company stock. The
10 Commission will apply the same regulatory principles and policies to Mountain after
11 the Wheeler family sells their stock in Park as it does now. In the rate setting
12 process, how the Commission will allocate common costs and corporate overheads
13 will remain unchanged, as well as its authority to determine Mountain's authorized
14 rate of return.

15 This Commission has jurisdiction over Mountain, not Park. The California
16 Public Utilities Commission has exclusive jurisdiction over Park, just as this
17 Commission has exclusive jurisdiction over Mountain. Mountain is proposing no
18 action, of any kind, which is the subject of this Commission's jurisdiction. It is Park
19 that intends to act, by transferring on its corporate records the ownership of its stock
20 from the Wheeler family to the Carlyle Group. It is the California Commission, not
21 this Commission, which will tell Park what it can or cannot do under California law.

22 Mountain, as the Montana jurisdictional utility, filed in good faith with this
23 Commission a petition that it disclaim jurisdiction over the sale of stock of a

1 California utility regulated solely by the California Commission. It is disconcerting
2 that this proceeding has degenerated into an attempted plebiscite on public versus
3 private ownership of the Mountain Water Company.

4 **Q. Please briefly summarize the testimony of the City of Missoula in this docket,**
5 **and explain how you intend to respond to it.**

6 **A.** The City of Missoula has presented the testimony of Mayor John Engen. In his
7 testimony, the City does not oppose the sale of the Wheeler family stock to Carlyle.
8 It indicates that the City wants to own Mountain Water Company, and needs an
9 opportunity to negotiate a deal with Carlyle. Mayor Engen testifies that the City of
10 Missoula would provide better consumer protections than Mountain as a regulated
11 public utility under the jurisdiction of this Commission. I will first place the City's
12 testimony in the proper context of this proceeding. As I have already testified, the
13 testimony is misplaced, as this Commission does not have authority to address, in
14 any way, public versus private ownership of Mountain. I will also explain my
15 disagreement with some of the things that Mayor Engen has said in his testimony.

16 **Q. Please address the City's testimony that it wants to own the Mountain Water**
17 **Company, and needs an opportunity to negotiate a purchase.**

18 **A.** The City is repeating the mistake it made in the 1980's when it unsuccessfully
19 attempted to condemn the Mountain Water Company. It is confusing city
20 government's desire to own the Company with the City of Missoula's actual need to
21 own the Company. Mountain does not doubt that Missoula city government wants to
22 own it. The unsuccessful condemnation action speaks loudly. The City wants to
23 own Mountain because its ownership of the system would provide city government

1 with a powerful tool to force annexation into the City and impose development fees.
2 Its ownership of Mountain Water would allow it to force annexation upon otherwise
3 unwilling landowners as a condition of receiving water service.

4 It is clear from Mayor Engen's testimony that the City believes its desire to
5 own Mountain translates into the need to own Mountain. That was the position taken
6 by the City in 1984. That position was rejected by the Montana courts. To acquire
7 Mountain against its wishes, the City must institute an eminent domain proceeding
8 against the Company in state district court, and make the rigorous showing of need
9 required by the Montana courts.

10 The City is not entitled to seek from this Commission what it has labeled "a
11 reasonable opportunity to purchase Mountain Water Company." It bears repeating
12 that this Commission does not sit as arbiter of whether the Mountain Water
13 Company should be under public ownership. The City is also confusing "negotiating"
14 with "taking." The City does not need an order from this Commission to negotiate
15 anything with Mountain, Park, or Carlyle. What it apparently wants is an order
16 compelling Mountain and Park to act against their own best interests.

17 **Q. Do you agree that the City would provide better consumer protections than**
18 **Mountain as a regulated utility subject to the jurisdiction of this Commission?**

19 **A.** I do not. In fact, I strongly disagree with Mayor Engen. If the City were to acquire
20 Mountain, this Commission would lose its regulatory jurisdiction over Mountain, and
21 the Commission would have no power to act on behalf of Mountain's customers.
22 Regulation by this Commission is rigorous and demanding. The Commission prides
23 itself as being a consumer oriented regulatory body. There have been times when

1 Mountain has felt that Commission regulation has unduly favored Mountain's
2 customers at the expense of the legitimate interests of Mountain. City government
3 historically had the same view on Commission regulation. The Commission used to
4 have regulatory authority over the rates and service provided by municipally owned
5 water utilities. After a series of Commission decisions which the cities thought unfair
6 to them, the cities convinced the Montana Legislature to eliminate the Commission's
7 regulatory authority over them.

8 Under PSC regulation our customers also have the constitutional protection
9 of the Montana Consumer Counsel. This agency along with the Commission have
10 rate analysts that pour through a regulated utility's records to make sure the utility is
11 providing good service at reasonable rates. A utility cannot increase its rates or
12 change the methods it provides service to the community without approval by the
13 Commission, with input from the MCC.

14 Under regulation by the Commission, if I or my staff decide to spend money
15 on a capital improvement or operating expense that is not necessary to provide
16 service to our customers, the Commission can require the cost be excluded from
17 rates. The community does not have to pay for our mistakes, the owner does.
18 Within the City, that type of decision by one of its departments, even when
19 determined by the city council to be an unwise expenditure, has to be paid for by the
20 community, either through ratepayers or taxpayers. The Commission's regulatory
21 control is one of the reasons private utilities make every effort to make sure their
22 decisions are the most cost effective way of providing service to their customers.

23 **Q. Do you have a recommendation as to how the Commission should respond to**

1 **the City's testimony in this case?**

2 **A.** I do. I believe the Commission needs to clearly and frankly communicate to the City
3 that the Commission has no authority to provide the City with the relief it has
4 requested. No one's interests will be well served if that does not occur.

5 **Q.** **Please briefly summarize the testimony of the Clark Fork Coalition in this**
6 **docket.**

7 **A.** The Clark Fork Coalition has presented the testimony of Mr. Charles Rial. In his
8 testimony, Mr. Rial does not oppose the sale of the Wheeler family stock to Carlyle.
9 In fact, he affirmatively states:

10 (1) Carlyle's ownership of Park does not present a risk to Mountain's
11 customers;

12 (2) Carlyle's financing plan will not burden Mountain's customers.

13 Mr. Rial identifies the Clark Fork Coalition's concern as being the next owner of
14 Park, in his words, the "post-Carlyle's ownership period." Rial, at page 2, lns 14-15.
15 Mr. Rial argues that the Commission should condition its approval of the sale of
16 Wheeler family stock to Carlyle upon the City of Missoula receiving a right of first
17 refusal to purchase Mountain from Carlyle. He goes so far as to suggest a method
18 for determining the price at which the sale would occur.

19 **Q.** **What is your response to Mr. Rial's testimony on behalf of the Clark Fork**
20 **Coalition?**

21 **A.** It is the same as my response to the testimony of Mayor Engen on behalf of the
22 City -- it is misplaced. This Commission has no authority to require a sale of
23 Mountain to the City. The Commission has no authority to establish an appraisal

1 methodology to value Mountain in a forced sale to the City.

2 **Q. Is Mr. Rial's concerns about the "post-Carlyle ownership period" valid?**

3 **A.** No. The fundamental issue in this case is whether this Commission can assert
4 jurisdiction over the Wheeler family's sale of their stock in the Park Water Company
5 to Carlyle. Let's assume for the sake of argument that the Commission successfully
6 asserts jurisdiction over a Wheeler to Carlyle sale in this docket. If the Commission
7 successfully asserts jurisdiction over a Wheeler to Carlyle sale, it also would have
8 jurisdiction over a Carlyle to Brand X sale. Stated another way, under a claim of
9 Commission jurisdiction in this case, the only way an unqualified buyer could acquire
10 Park Water from Carlyle is if the Commission allowed it to happen.

11 **Q. Isn't the Clark Fork Coalition's stated concern really about a Carlyle sale of**
12 **Mountain Water Company to an unqualified buyer, not the sale of Park Water**
13 **Company to an unqualified buyer?**

14 **A.** No it is not. The Clark Fork Coalition knows that my company, Mountain, has
15 already offered a 90 day opportunity to the City to acquire the Mountain Water
16 Company, should it be put up for sale. What Mr. Rial is attempting to do is expand
17 that opportunity to apply to a sale at the parent level, a sale of Park. However, even
18 if the Clark Fork Coalition confined its proposal solely to a proposed sale by Park of
19 Mountain as the triggering event, it would not change the analysis I just provided. If
20 the Commission successfully asserts jurisdiction in this case over the sale of stock in
21 a non-jurisdictional utility, it necessarily has jurisdiction over the sale of stock in, or
22 the assets of, a jurisdictional utility.

23 **Q. Do you have a recommendation as to how the Commission should respond to**

1 **the testimony of the Clark Fork Coalition in this case?**

2 **A.** I do. As in the case of the City, I believe the Commission needs to clearly and
3 frankly communicate to the Clark Fork Coalition that it has no authority to provide it
4 the relief it has requested. No one's interests will be well served if that does not
5 occur.

6 **Q. Please briefly summarize the testimony of the Montana Consumer Counsel in**
7 **this docket, and explain how you intend to respond to it.**

8 **A.** The Montana Consumer Counsel has presented the testimony of Dr. John Wilson.
9 In his testimony, Dr. Wilson does not oppose the sale of the Wheeler family stock to
10 Carlyle. His testimony addresses two subjects:

11 (1) His concern that Carlyle's business plan contains an unrealistically
12 aggressive plan to invest in main replacements, to the detriment of
13 Mountain's customers;

14 (2) His belief that the sale of the Wheeler family's stock to Carlyle, and
15 what he deems Carlyle's aggressive business plan, makes this an opportune
16 time for the Commission to impose ring fencing conditions upon the Mountain
17 Water Company.

18 I will address each segment separately, and offer my recommendations on
19 how the Commission should respond to them.

20 **Q. Please first address Dr. Wilson's concerns about what he believes to be**
21 **Carlyle's overly aggressive business plan.**

22 **A.** Within a limited context, I agree with much of what Dr. Wilson has said about the
23 need to restrict main replacement to main replacements which are economically

1 sound. As I have testified to this Commission in previous proceedings, we need to
2 replace leaking mains when we can do it in a cost effective manner. We neither
3 need, nor want, to replace main under a regulatory regime or business plan that fails
4 to recognize that cost effectiveness is the guiding force for our endeavors.

5 Clearly, Carlyle takes environmental stewardship seriously, and is concerned
6 about the rate of leakage on the Mountain system. I believe that concern is what is
7 reflected in the excerpts of Carlyle's confidential purchase memorandum, which is
8 being referenced by Dr. Wilson in his testimony. The preparation of that memo
9 obviously preceded Carlyle's entry into the stock purchase agreement under which it
10 will acquire Park. Since that agreement has been executed, I have had extensive
11 discussions with Carlyle about the impact of an aggressive main replacement
12 program on Mountain's rates, and the need for moderation. I believe that Carlyle is
13 fully committed to the type of main replacement programs that Mountain has already
14 discussed with this Commission in previous proceedings. I believe that is reflected
15 in the testimony of Mr. Dove in which he states:

16 In our view, these initial steps are critical as we develop a well thought
17 out, comprehensive plan to address the problem of replacing aging
18 infrastructure to promote conservation while at the same time being
19 mindful of the impacts on customer rates.

20
21 Dove, at page 6, lns 4-7.

22 I assure the Commission that the management of Mountain Water Company
23 does not intend to embark upon a main replacement program which is not cost
24 effective for its customers, and which is not fully supported by this Commission. It
25 may be helpful to recall that an earlier Commission, with different Commissioners,

1 was pressing Mountain to more aggressively pursue main replacement. It was
2 Mountain which urged moderation in the interests of its customers. Dr. Wilson's
3 testimony in this proceeding quotes my testimony in an earlier Commission
4 proceeding, urging such moderation.

5 **Q. Do you have a recommendation as to how the Commission should respond to**
6 **Dr. Wilson's concerns about over investment in replacement main?**

7 **A.** I do. The management of Mountain fully supports a Commission statement in this
8 docket that main replacement should occur only when it is cost effective for
9 Mountain and its customers.

10 **Q. How do you intend to address Dr. Wilson's proposal to use this docket as an**
11 **opportunity to impose ring fencing conditions?**

12 **A.** I will first address his proposal in general terms, to provide an appropriate context. I
13 will then address each of his proposed ring fencing conditions in sequence.

14 **Q. Please address Dr. Wilson's ring fencing proposal in general terms.**

15 **A.** The proposed stock sale which is the subject of this proceeding in no way changes
16 the relationship of Mountain to its parent, Park, and in no way changes the
17 relationship of either Mountain, or its parent Park, to this Commission. The ring
18 fencing provisions which Dr. Wilson suggests are the type of provisions that
19 Commissions sometime consider when their jurisdictional utilities are acquired by
20 non-jurisdictional entities. The ring fencing provisions are intended to preserve a
21 Commission's regulatory jurisdiction, to protect against potential abuse by the
22 acquiring non-jurisdictional entity.

23 This case does not involve the acquisition of a jurisdictional utility by a non-

1 jurisdictional entity. It involves the sale of stock of a non-jurisdictional entity. In this
2 case, the jurisdictional utility, Mountain, has been owned by a non-jurisdictional
3 entity, Park, for more than thirty years. The Commission has successfully and
4 rigorously regulated Mountain for more than thirty years without any of the ring
5 fencing provisions proposed by Dr. Wilson in this case.

6 It is Park Water Company, a California jurisdictional utility, which is being
7 acquired by a non-jurisdictional entity (in the state of California). Some of Dr.
8 Wilson's ring fencing proposals are, in effect, an attempt to ring fence Park from its
9 acquiring entity, Carlyle. It is the responsibility of the California Commission, not the
10 Montana Commission, to determine appropriate ring fencing for Park. Some of what
11 Dr. Wilson denominates "ring fencing proposals" are in fact attempts to directly
12 regulate Park Water Company, which is not subject to the Commission's jurisdiction.
13 Perhaps the clearest examples are his proposal to specify a mandatory capital
14 structure for the Park Water Company, Proposed Condition (e), and his proposal to
15 make debt issuance by Park the subject of Commission approval, Proposed
16 Condition (d).

17 His proposed condition to regulate debt issuance highlights another flaw in
18 his proposals. Even if Park was subject to the Commission's jurisdiction, the
19 Commission would not have authority to regulate its issuance of debt or other
20 securities. The Commission doesn't have that authority over Mountain, let alone
21 Park. The Commission's authority over the issuance of debt and other securities is
22 limited to the issuances of certain electric and gas utilities. The Commission has
23 never had authority to regulate the issuance of debt or other securities by the water

1 utilities or telecommunications carriers it regulates.

2 **Q. Please explain how you will address sequentially the ring fencing conditions**
3 **which Dr. Wilson proposed in his testimony.**

4 I thought it would be helpful to the Commission to see each of Dr. Wilson's
5 proposals with legislative annotation showing the modifications I believe are both
6 desirable and necessary. Following each proposal, I explain why I made the
7 modifications reflected in the legislative annotation.

8 Proposed Condition (a)

9 a. The Commission or its agents may audit the accounts of Mountain
10 Water Company ("MWC"), and Park Water Company ("Park") ~~together with its~~
11 ~~affiliated utilities, its parent and its subsidiaries and affiliates which are the~~
12 ~~bases for charges to, or transfers from MWC or its parent. MWC and its~~
13 ~~parent~~ and both shall cooperate fully with such Commission audits.

14 After Carlyle acquires the stock of Park, Carlyle and Park will be affiliated
15 companies. Neither this Commission nor the California Commission will have
16 regulatory authority over Carlyle, as it is not a regulated utility. The changes shown
17 in the legislative annotation reflect not only the correct jurisdictional boundaries, they
18 embody the historic practice of this Commission. In every Mountain Water rate case
19 in which I have participated, both the Commission and the Montana Consumer
20 Counsel audit the books and records of both Mountain and Park. The Mountain
21 audit occurs at the offices of Mountain in Missoula, and the Park audit occurs at the
22 offices of Park in Downey, California.

23 Proposed Condition (b)

1 b. MWC and Park ~~its parent~~ shall provide the Commission access to their
2 all books of account, as well as all of their documents, data and records of
3 their affiliated utilities interests, which pertain to transactions between MWC
4 and Park ~~its parent~~ and or its affiliated utilities interests.

5 The changes shown in the legislative annotation follow the changes shown in
6 the legislatively annotated Proposed Condition (a), and reflect the correct
7 jurisdictional boundaries and historical practice of the Commission.

8 Proposed Condition (c)

9 c. MWC shall maintain its own financial and business operating
10 accounts, separate from Park's ~~its parent's~~ and its utility affiliates' accounts.
11 All financial and operating books and records of MWC and ~~those of its parent~~
12 and ~~subsidiaries~~ shall be completely and immediately accessible at Missoula,
13 Montana.

14 A company's financial records are not a few sheets of paper which can be
15 copied and sent to Missoula. Both Mountain and Park are required to maintain
16 sophisticated and sometimes complex electronic accounting systems to comply with
17 accounting and regulatory requirements. Obviously, it makes sense for Mountain to
18 maintain its accounting systems and records in Missoula, and it makes sense for
19 Park to maintain its accounting systems and records in Downey, California. It would
20 make no sense to have a regulatory requirement which required Park to maintain a
21 redundant second system in Missoula. When the Commission has desired to audit
22 Park's books and records, it has never required the audit to occur in Missoula. It has
23 always wanted the audit to occur where the electronic systems, data, and people

1 who maintain them are located. The changes shown in the legislative annotation are
2 not only a practical necessity, they reflect the historic practice of the Commission.

3 Proposed Condition (d)

4 d. ~~There is no provision that MWC shall maintain its own debt, in~~
5 ~~recognition of the historic practice of MWC's parent issuing debt on a~~
6 ~~consolidated basis. If these financing circumstances change in the future or if~~
7 ~~debt is to be incurred for acquisition purposes, appropriate debt ring-fencing~~
8 ~~conditions may be required. If, at any time, MWC's parent or affiliates intend~~
9 ~~to issue debt for the purpose of acquiring other utility or nonutility~~
10 ~~companies, those financing intentions must be filed with the Commission at~~
11 ~~least 120 days in advance of any such financing so that the Commission may~~
12 ~~implement appropriate debt ring-fencing provisions.~~

13 The legislative annotations reflect the complete elimination of this proposed
14 condition. As I testified earlier, the Commission does not regulate the issuance of
15 securities by its jurisdictional water utilities and telecommunications carriers.
16 California does regulate the issuance of securities by Park, in California.

17 Proposed Condition (e)

18 e. MWC shall not make any distribution to Park ~~its parent or to any~~
19 ~~affiliates that would cause MWC's equity capital to fall below 45 percent of~~
20 ~~total capitalization MWC's net utility plant balance (utility plant in service less~~
21 ~~accumulated depreciation and amortization).~~ without first obtaining
22 Commission approval. ~~Also, MWC's parent, Park Water, shall maintain a~~
23 ~~capital structure equity percentage of at least 45 percent, on a Park and~~

1 ~~subsidiaries consolidated basis, except to the extent that the Commission~~
2 ~~imputes a lower equity percentage for ratemaking purposes. The~~
3 ~~Commission may re-examine these minimum common equity percentages as~~
4 ~~financial conditions change, and may determine that they be adjusted.~~

5 As I testified earlier, the Commission has no regulatory authority over Park. It
6 would be completely inappropriate for this Commission to try and specify a
7 mandatory capital structure for Park Water Company in this, or any other Montana
8 proceeding. Although I don't think the provision is necessary, the legislative
9 annotations leave intact a specified minimum equity component for Mountain. I
10 should note the Commission has criticized Mountain for maintaining a capital
11 structure which the Commission deemed to be equity rich. It has never suggested
12 that Mountain is equity thin.

13 Proposed Condition (f)

14 f. ~~MWC and its parent shall provide the Commission unrestricted access~~
15 ~~to all written information provided to common stock, bond, or bond rating~~
16 ~~analysts, which directly or indirectly pertains to MWC, its parent or any~~
17 ~~affiliate that exercises influence or control over MWC. Such information~~
18 ~~reports provided to, and presentations made to, common stock analysts and~~
19 ~~bond rating analysts. For purposes of this condition, "written" information~~
20 ~~includes but is not limited to any written and printed material, audio and video~~
21 ~~tapes, computer disks and electronically stored information. Nothing in this~~
22 ~~condition shall be deemed to be a waiver of MWC's right to seek protection of~~
23 ~~the information.~~

1 The legislative annotations reflect the complete elimination of this proposed
2 condition. It has no relevance to either Mountain or Park, as neither is a publicly
3 traded company, and neither issues publicly traded debt.

4 Proposed Condition (g)

5 g. Unless such a disclosure is determined to be unlawful in an opinion of
6 counsel provided to the Commission, MWC shall notify the Commission of:
7 any declaration of dividends 30 days in advance.

8 ~~1. Its intention to transfer more than 5 percent of MWC's retained~~
9 ~~earnings to its parent or affiliates (or any combination thereof) over a six-~~
10 ~~month period, at least 60 days before such a transfer begins.~~

11 ~~2. Its intention to declare a special cash dividend from MWC, at least 30~~
12 ~~days before declaring each such dividend.~~

13 ~~3. Its most recent regular common stock cash dividend from MWC within~~
14 ~~10 days after declaring each such dividend.~~

15 I considered deleting this proposed condition in its entirety. Mountain has
16 had an upstream parent since it was formed (Park), and the Commission has not
17 had the need or desire to impose such restrictions upon Mountain. However, I
18 recognize that Mountain has not historically dividended much money upstream to
19 Park. I am very concerned that subsection (1) is so ambiguous, that it could be
20 construed to apply to cash management agreements. The legislative annotations
21 reflect a common sense approach to providing the Commission with advance notice
22 of any upstream dividend.

23 Proposed Condition (h)

1 h. ~~MWC's parent, subsidiaries and affiliates shall not allocate to or~~
2 ~~directly charge MWC expenses not specifically authorized by the Commission~~
3 ~~to be so allocated or directly charged.~~

4 The legislative annotations reflect the complete elimination of this proposed
5 condition. Cost allocation only has relevance to this Commission in a Mountain
6 Water rate case. It is completely impractical to suggest that henceforth, cost
7 allocation in Mountain rate cases will be in accordance with Commission prescribed
8 directives on cost allocation instead of through the application of basic accounting
9 principles. I am unaware of this Commission trying to prescribe a system of cost
10 allocation for any of the utilities it regulates. In a rate case, the Commission is free
11 to disagree with accounting principles, or the application of accounting principles,
12 used by Mountain or Park in the proceeding. There is nothing unusual about that, as
13 the Commission and the MCC scrutinize all cost allocations in Mountain's rate
14 cases.

15 Proposed Condition (i)

16 i. Without the prior and specific authorization of the Commission, ~~neither~~
17 ~~MWC nor its parent shall not transfer, merge, or sell, lease, encumber or~~
18 ~~otherwise dispose of MWC's utility property which (a) has a net book value in~~
19 ~~excess of \$1,000,000 and which is included in Montana rate base., and (b)~~
20 ~~has costs recovered through rates regulated by the Commission.~~

21 As I have already testified, the Commission does not have regulatory
22 authority over the security issues of water utilities, and does not have authority over
23 Park Water. The legislative annotations reflect these boundaries on the

1 Commission's jurisdiction.

2 Proposed Condition (j)

3 j. ~~The following principles shall apply to any new financing involving~~
4 ~~utility property of MWC which (a) is included in Montana rate base, or (b) has~~
5 ~~costs recovered through rates regulated by the Commission:~~

6 a. ~~proceeds of debt that is secured by utility assets must be used for~~
7 ~~utility purposes only;~~

8 b. ~~if any utility assets that are pledged or encumbered to secure debt~~
9 ~~issuances are divested, the debt must 'follow' the assets and be divested as~~
10 ~~well;~~

11 c. ~~if utility assets financed by unsecured debt are divested to another~~
12 ~~entity, then a proportionate share of the debt also must be divested;~~

13 d. ~~if assets financed with unsecured debt are divested, the associated~~
14 ~~unsecured debt must follow those assets. Specifically, if any of the proceeds~~
15 ~~from unsecured debt are used for non-utility purposes, the debt likewise must~~
16 ~~"follow" the non-utility assets and if the non-utility assets are divested or "spun~~
17 ~~off" then a proportionate share of the debt must follow the associated non-~~
18 ~~utility assets by being divested or "spun off" as well. The term "divested" in~~
19 ~~this context includes moving assets to both affiliated and non-affiliated~~
20 ~~corporations.~~

21 The legislative annotations reflect the complete elimination of this proposed
22 condition. Although this Commission has, in the past, examined whether Mountain
23 should issue its own debt, Mountain has not historically done so. The only exception

1 is the recent ARRA related financing for main replacement which is funded by a
2 tariffed tracking adjustment approved by the Commission in PSC Docket No.
3 D2009.12.154. With that exception, all debt capital is raised at the Park level, not
4 the Mountain level. This Commission does not have jurisdiction over Park debt
5 issues. To the extent such issues might adversely affect Mountain's customers in
6 the Montana rate making process, the Commission is already equipped to prevent
7 such an occurrence in a rate case. Also, as I have already noted several times, this
8 Commission does not have jurisdiction over security issuance by any water utility.

9 Proposed Condition (k)

10 k. In the event that MWC ~~desires to change or its parent participates in a~~
11 ~~"its current cash management agreement with Park, pool" or "treasury pool"~~
12 ~~arrangement, or otherwise engages in intra-corporate financing with affiliates,~~
13 MWC shall incorporate file for Commission approval a cash management
14 plan incorporating best practices for protecting MWC's and it parent's credit
15 from any the risks associated with participating in the agreement. a shared
16 money pool with such affiliates. and shall provide the Commission with 30
17 days advance notice of such changes.

18 Mountain has had a cash management arrangement or agreement with Park
19 for many years, and it has never posed a problem to the Commission or the MCC.
20 The legislative annotations reflect that Mountain already has a cash management
21 agreement with Park, ~~and focus the specified Commission approval on significant~~
22 ~~changes to the cash management agreement.~~

1 Q. Does this complete your testimony?

2 A. Yes it does.

CERTIFICATE OF SERVICE BY MAIL

I **HEREBY CERTIFY** that a copy of the foregoing **REBUTTAL TESTIMONY OF JOHN KAPPES** was served upon the following by mailing a true and correct copy thereof on this 2nd day of September, 2011, addressed as follows:

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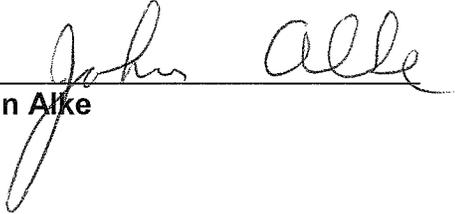
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