DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF the Application of **MOUNTAIN WATER COMPANY** for Authority to Increase Rates and Charges for Water Service to Its Missoula, Montana Customers)	**UTILITY DIVISION** **DOCKET NO. 2012.7.81** **REPLY BRIEF**

INTRODUCTION

Mountain Water Company ("Mountain") filed its Opening Brief on August 20, 2013. The Montana Consumer Counsel ("MCC") filed its Response Brief on August 30, 2013. Mountain respectfully submits its Reply Brief in accordance with the Commission's scheduling for post hearing briefs.

The MCC Response Brief is an interesting read. It twists the record in this docket beyond recognition. It is spiced with pejorative words and phrases like "innuendo",[1] "misdirection"[2] and "cherry picking".[3] The Commission should not be persuaded by the tone of the MCC brief. When it determines the cost of equity capital in this proceeding, it should be calmly guided not only by the empirical results of the various DCF studies in evidence in this docket, but its obligation to render decisions in a non-arbitrary manner.

Although the MCC declares the 9.8% return on equity recently authorized by the Commission for NorthWestern Energy in PSC Docket D2012.9.94 "irrelevant",[4] it is not. MCC witness Wilson prepared three contemporaneous cost of equity studies for Mountain,

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[1] Response Brief at p. 12.

[2] Response Brief at p. 17.

[3] Response Brief at p. 10.

[4] Response Brief at p. 12.

NorthWestern Energy, and Montana-Dakota Utilities Co. His recommendations, contained in sworn testimony, were that the cost of equity for Mountain was only 25 basis points lower than for NorthWestern or Montana-Dakota. Moreover, as shown at hearing, and demonstrated again in Mountain's Opening Brief, Dr. Wilson's DCF results actually suggest a higher cost of equity for Mountain than either NorthWestern or Montana-Dakota.

Given the unusual circumstance that the MCC expert prepared three contemporaneous cost of equity studies for Mountain, NorthWestern Energy, and Montana-Dakota Utilities Co., the Commission's determination that the cost of equity capital for NorthWestern was significantly higher than contended by Dr. Wilson in his sworn testimony is highly relevant. Quite frankly, the MCC's advocacy on cost of equity in this docket is inexplicable, given its agreement with NorthWestern Energy that the cost of equity capital for NorthWestern should be set at 9.8%, 115 basis points higher than now advocated by the MCC for Mountain. While the MCC is certainly entitled to destroy its own credibility, it should not expect the Commission to follow suit.

ARGUMENT

I. Copper Horns

The Response Brief urges the Commission to adopt all revenue adjustments proposed by MCC witnesses in either their pre-filed testimony or at hearing.[5] MCC witness Schulz proposed a revenue adjustment related to the accounting for copper horn inventory in his pre-filed testimony. MCC Ex. 3 at 11-12. At hearing he indicated that, after reviewing the information contained in Mountain's Rebuttal testimony, he agreed with Mountain's position on the proper accounting for copper horns. Tr. 328-329. Presumably, the MCC meant to indicate

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[5] "The Commission should further adopt MCC's recommendations regarding all revenue adjustments as set forth in pre-filed testimony, exhibits and direct testimony at hearing." Response Brief at 2.

in its brief that the Commission should not make the adjustment for copper horns proposed by MCC witness Schulz in his pre-filed testimony.

II. Health Insurance Premiums.

Mountain is currently paying health insurance premiums for coverage for its employees at a rate established in 2012 for coverage beginning in 2013. Mountain believes the premium change should be reflected as a known and measurable change to historic test year data; the MCC believes it should not.

The MCC appears to argue that Mountain conceded the position of the MCC in its responses to data requests. Response Brief at 14. That is not true. Mountain's Response to Data Request PSC-60(b) clearly supports its position, not the position of the MCC. It indicates in pertinent part:

> Mountain believes that the proper pro-forma expense for medical and dental insurance is the annualized 2013 premium expense, which was known and measurable with certainty by October 2012. The documents legally binding the employees to their benefit elections were signed and submitted to Mountain and Park by early November. Those documents defined the required employee contributions for the 2013 premium period, this obligating the employer to the balance of the premium expense. The first installment of the employee portion of the 2013 premiums was withheld from employee pay during the pay period of December 17-30, 2012. At that point, the increased level of expense was in effect.

Mountain Response to Data Request PSC 60 at p. 2. (The entire response is attached as Appendix 1.) Mountain witness John Kappes testified, without contradiction by any other witness in the case, that:

> Health insurance expense was known and measurable during that period. The health insurance policy is renewed annually, and the renewal process typically begins in July. On behalf of its subsidiaries, Park Water contracts with Mercer to research coverage options, request quotes from carriers, negotiate benefit and premium packages, and advise the company on the best strategy to meet its objectives. This process culminates in October with presentations to employees of coverage and premium plans for the following year. The employees make an irrevocable election for coverage and flexible spending plan deferral amounts by mid-November. Premiums for the new policy year are withheld starting the last pay period of the prior year. For 2012, employees paid

> the first installment on the 2013 health insurance premium during the pay period December 17-30, 2012. At the point, the higher level of expense was in effect.

MW Ex. 3 at p.1.

The MCC ignores the difference between the policy period in a contract for health insurance, and when the cost of the insurance being provided under that contract are known and measurable. The Commission is setting rates for the future in this docket, not the past. Despite the fact that the premiums currently being paid by Mountain are for health insurance coverage for the 2013 policy period, the cost of that coverage was "known and measurable" in the Fall of 2012, well within the 12 month change period contained in ARM 38.5.106. It became "effective" as soon as Mountain accepted the insurance offering and tendered it to its employees for the required elections, which also occurred in the Fall of 2012.

ARM 38.5.106 does not dictate outcomes in Commission rate orders. It is part of the Commission's Minimum Rate Case Filing Standards for general rate case filings by electric, gas, and privately owned water utilities.[6] Those standards simply prescribe what information a utility must provide in a general rate case filing. Importantly, they are subject to waiver: "All or any part of the requirements of these rules may be waived by a quorum of the Commission upon a showing of good cause." ARM 38.5.102(3). *See also* ARM 38.2.305(1).

The Commission's Minimum Rate Case Filing Standards do not proscribe the filing of additional information, or prohibit a utility from seeking rate treatment in a rate case different than what has been afforded by the Commission in past rate cases. For example, a filing utility could present a fully projected test year in a general rate case filing, and request the establishment of rates on the basis of the fully projected test year, as long as it also provided in its initial filing a historic test year as required by ARM 38.5.106. In other words, it is within

[6] "Applications for rate increases exceeding one hundred thousand dollars annually shall include the cost of service to be supplied and shall include the additional material required in ARM 38.5.103 to 38.5.175 and 38.5.179 to 38.5.183, inclusive, minimally." ARM 38.5.102(1).

the discretion of the Commission to establish rates in this docket which utilize the actual cost of health insurance being paid by Mountain instead of an outdated premium rate.

This is not a case where the inclusion of the current health insurance premium costs in rates would cause a matching problem. There are no offsetting revenues associated with reflecting the current cost of health insurance in rates. Denying the recovery of current health insurance costs fulfills no meaningful public policy. All it does is delay cost recovery until the next Mountain rate case, where the test period health insurance costs will likely again understate the actual costs of obtaining the insurance during the period of time the rates will be effective.

The MCC argues that the Commission is <u>required</u> to reflect health insurance costs at the rates which were superceded in 2012. Response Brief at pp. 15-17. The Commission should categorically reject the MCC assertion that the Commission has no discretion in this matter.

The MCC citation to Montana Supreme Court cases for the proposition that the Commission must follow its own rules is not meaningful in the context of the issue in this case. The rules which the MCC argues the Commission must follow <u>expressly</u> provide for waiver. More importantly, as discussed above, ARM 38.5.106 does not dictate rate case outcomes. It is simply part of the Commission's Minimum Rate Case Filing Requirements, which specify what information a utility must provide in its initial rate case filing.

III. <u>Cost of Equity</u>

A. <u>Overview</u>.

According to the MCC: "MWC does not seriously contest the results of Dr. Wilson's technical analysis other than to argue it is entitled to a risk premium to account for its small size..." Response Brief at 6. The MCC appears to have confused this proceeding with some other case. Not only did Mountain contest the results of Dr. Wilson's analysis, it established that:

(1). Dr. Wilson's pre and post "Carlyle Acquisition" cost of capital studies showed no change in Mountain's cost of equity capital; MCC Ex. 1, internal Exhibit_(JW-6); MW. Ex. 13 at p. 3.

(2) Dr. Wilson's cost of equity studies supported a higher cost of equity capital than he recommended for NorthWestern Energy; MCC Ex. 1, internal Exhibit_(JW-6); MW. Ex. 11 at p. 3.

(3) If Dr. Wilson had performed his cost of equity studies correctly, they would have shown a cost of equity for Mountain between 10.4% and 10.7%, <u>before</u> consideration of the risk of Mountain relative to Wilson's proxy companies. Rebuttal Testimony of Tom Zepp, MW Ex. 9 at pp. 28-29, and internal Exhibit __(TZ-1) at p. 16.

The MCC went so far in its Response Brief as to suggest that Mountain witness Leigh Jordan agreed with the MCC that the acquisition of Park Water Company by a Carlyle Group infrastructure fund affected Mountain's cost of equity capital. Response Brief at p. 5. Mr. Jordan's testimony was the exact opposite:

> A. I don't think I agree with that. What I'm saying is that the risk and appropriate return of holding the stock of an entity is independent of who it is that's holding the stock. So if – in this example that you have on the board here, if this hypothetical company, HW, was a company that was essentially identical to Mountain Water Company and had the same risk, then whoever purchased the stock of either one of them would expect to have, essentially, the same return for accepting the risk of holding those stocks. So I don't see where it makes a difference as to where the money went into the system.
>
> Q. Okay. But the cost of equity capital that is being supplied to Park and to Mountain Water, that equity, the cost of that equity capital is a reflection of the Carlyle Group; isn't that correct?
>
> MR. ALKE: Objection, asked and answered. He's already said that's not true.

Q. (BY MS. TRANEL) You don't – that's not accurate from your perspective? You disagree with that statement?

MR. ALKE: I would like a ruling on my objection. I object. The question has already been asked and answered. He said that's not true, previously. She's asked the same question again.

MS. TRANEL: Mr. Chairman, I'll –

VICE CHAIR LAKE: Could you rephrase?

MS. TRANEL: Yes, I will.

Q. (BY MS. TRANEL) Okay, this is a lengthy question. So here's the question, Mr. Jordan: Do you agree with me that it's the cost of the equity capital supplied to these Carlyle investment fund vehicles that should be reflected in the common equity return allowance approved by the Commission in this case?

A. No.

Q. You don't agree with me. Okay, thank you. I will move on and ask another question....

Tr. 120-121.

B. Dr. Wilson's pre and post "Carlyle Acquisition" cost of capital studies showed no change in Mountain's cost of equity capital.

At hearing, and in its Opening Brief, Mountain showed how Dr. Wilson's own cost of capital studies established that there was no change in Mountain's cost of equity capital between PSC Docket 2010.4.41 and this docket, PSC Docket 2012.7.81. Mountain's 2010 rate case pre-dated the acquisition of Park Water Company by a Carlyle Group infrastructure fund, and this rate case is obviously after the acquisition. Dr. Wilson performed cost of capital studies for the MCC in each case. As explained in Mountain's Opening Brief:

> Although his methodologies produce unreasonably low numbers, they reflected no significant change in the cost of capital between Mountain's 2010 rate case (PSC Docket D2010.4.41) and its 2012 rate case (this docket). In the 2010 rate case, before the stock of Park Water Company was purchased by Western Water Holdings LLC, his average measure of the cost of equity capital for

> Mountain was 7.5%. Ex. MW-13, internal Exhibit __(JW-7). In this rate case, <u>after</u> the stock of Park has been purchased, his average measure is essentially the same - 7.4%. Ex. MCC-1, internal Exhibit __ (JW-6).

Opening Brief at p. 5.

The MCC response is to argue that since the Dr. Wilson's 2012 "average result" was 10 basis points lower than his "average result" for 2010, that is proof that the cost of equity capital for Mountain has decreased since the last rate case. Response Brief at pp. 9-10. The MCC does not attempt to explain how a 10 basis point drop in Dr. Wilson's "average result" between the two dockets justifies his recommendation for a 125 basis point drop.

Mountain was being charitable to Dr. Wilson when it used his "average result" to show that his own studies showed there was no change in Mountain's cost of capital between the two dockets. As noted in Mountain's Opening Brief, this Commission relies almost exclusively upon DCF estimates in arriving at a utility's cost of equity capital.[7] In both dockets, Dr. Wilson developed four different DCF estimates of Mountain's cost of equity capital. <u>Two of his four estimates showed Mountain's cost of equity capital increasing after the Carlyle acquisition</u>. One showed no change. Only one, his Fundamental DCF, depicted a drop in Mountain's cost of equity capital after the Carlyle acquisition.

	2010 Dkt Results	2012 Dkt Results
DCF - Earnings Growth	8.6%	9.5%
DCF - Dividend Growth	6.8%	7.6%
DCF - Back Value Growth	6.6%	6.6%
Fundamental DCF	8.5%	6.9%

[7] Mountain Opening Brief at p. 6.

MCC Ex. 1, internal Exhibit__(JW-6); MW Ex. 13 at p. 3. Importantly, Dr. Wilson's Fundamental DCF uses a different, and lower, measure of dividend yield that his other three DCF estimates.[8]

The simple fact of the matter is that Dr. Wilson's own cost of capital studies, his empirical evidence, discredit his ultimate recommendation in this docket. Although he opines that Mountain's cost of equity capital has dropped dramatically since the last docket, his own cost of capital studies show otherwise.

This Commission has commented adversely before on recommendations from the Wilson firm which depart from the empirical studies performed by the firm and presented to the Commission:

> With respect to Dr. Smith's DCF analysis, the following examination is unsettling:
>
> Q. Isn't it true, Dr. Smith, that over the last three years, you have raised your recommended cost of equity capital over the same period of time that your DCF model has been showing a lower cost of equity capital?
>
> A. I know that both in this proceeding and the proceeding prior to this one my estimate was higher than the results of the model. Before that, I just – I don't recall.
>
> Q. Will you accept that, subject to check, that your DCF model has shown declining cost and you have gone exactly the opposite direction and have shown an increasing cost?
>
> A. This is the third time that I've testified. The last two I know that I've gone above the model. It would not be – I would not be surprised to see the number declining, and I will check.
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> * * *

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[8] The DCF formula is supposed to be dividend yield plus investor expected growth in dividends. (E.g. MCC Ex. 1 at p. 11.) As an example of what Dr. Wilson has done, he used a current dividend yield of 3.3% for his proxy company American States, in his three DCF models using earnings growth (internal Exhibit–(JW-1), p. 2), dividend growth, and book value growth (internal Exhibit_(JW-2), p. 2). In his fundamental DCF, he used a much lower number for current dividend yield, 2.6%, (internal Exhibit_(JW-3), p. 2).

A. I don't understand what you're asking me.

Q. The DCF model the last three times has shown continually lowering cost of equity. You understand that.

A. For MDU –

Q. For MDU.

A. You have suggested, and I think that's probably right, that the numbers are getting lower. I think that's probably correct.

Q. Your recommended cost of MDU equity has gone the opposite direction, gone up the last three dockets.

A. That's correct as well.

* * *

Dr. Smith has used a DCF model which has produced lower results in each of the last three dockets, while her return recommendations have increased. Dr. Smith generally attributed that result to the effect of MDU's nonutility operations and its resource mix relative to the industry. While the factors discussed by Dr. Smith probably effect MDU's equity costs relative to the electric industry, no quantitative analysis of such effect was presented. <u>The Commission has consistently relied upon the quantitative results of DCF analysis to avoid undue reliance upon subjective judgment. While recognizing that adherence to quantitative analysis cannot be "blind," the results provided by Dr. Smith in this case do not adequately satisfy that policy.</u>

In the Matter of the Application of Montana-Dakota Utilities Co. To Adopt Increased Rates for Electric Service in the State of Montana, PSC Docket 81.1.2, Order 4799b, ¶ 41 (emphasis supplied) (ellipses not in original) .[9] It would be an abuse of the Commission's discretion to give credence to an expert opinion which is not supported by the expert's own data.

These statements are in the nature of conclusions and are of little weight unless supported by evidence showing factual data."

Freight Rate Association v. Railroad Commission, 128 Mont. 127, 1`34, 271 P. 2d 1024 (1954).

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[9] Dr. Smith was, at the time, Dr. Wilson's wife, and a member of his firm.

C. Park's recent debt issuance does not establish a lower cost of equity capital for Mountain.

The MCC expends considerable effort arguing that the favorable interest rate on Park Water Company's most recent debt issue proves that its acquisition by a Carlyle Group infrastructure fund has lowered Mountain's cost of equity capital. There are several significant problems with the MCC hypothesis:

(1) The MCC is confusing the cost of debt capital with the cost of equity capital;

(2) The cost of debt for all Triple B rated debt was low when Park obtained the favorable interest rate, and;

(3) Dr. Wilson's own cost of equity studies contradict his hypothesis.

The Commission should not be persuaded by a hypothesis which lacks factual support.

Park Water Company did obtain a very favorable coupon rate, 4.53%, on a $15 million bond issue. The bonds were issued in June of this year, but the terms of the issue were set in March. Tr. 165. Although the rate was quite favorable, it was still higher than the debt cost associated with a Triple B rated utility. Tr. 323. Similarly, NorthWestern Energy was able to secure a 4.15% coupon rate on a similar debt issue in the same approximate time frame. Mountain's Late Filed Ex. 2. These favorable coupon rates do not establish a reduced cost of equity, but a reduced cost of debt due to a generally favorable debt market. Although interest rates are currently low, the current risk premium between debt and equity is very high. Sur-Rebuttal Testimony of Dr. Tom Zepp, MW Ex. 10, at pp. 5-6.

The MCC is trying to make a last minute risk-premium argument, without actually conducting a risk-premium study. Even if it had conducted a well documented risk-premium study (which it did not), the Commission would rely on the DCF studies in this docket as the primary determinant of the cost of equity capital. Dr. Wilson's DCF studies in the 2010 rate case and this rate case establish that Mountain's cost of equity capital has not dropped in the last two years, and totally contradict his naked hypothesis surrounding Park's June debt issuance.

D. Mountain cost of equity capital is higher than the cost of capital for the proxy companies in the DCF analyses.

Both Mountain witness Jordan, and Mountain witness Dr. Zepp, explained why the cost of equity capital for Mountain is higher than the average cost of capital for the proxy water utilities used in the DCF analyses. Both Mountain, and its parent company Park, are small closely held companies. Even Park consolidated (which includes Mountain) is much smaller than the smallest proxy water utility used in the DCF analyses. Park consolidated has approximately $171 million in net plant. Direct Testimony of Dr. Tom Zepp, MW Ex. 9, internal Exhibit_(TZ-1), p. 15. The smallest proxy water utility, York Water, has approximately $240 million in net plant. Id. The largest proxy water utility, American Water Works, has approximately $11.38 billion in net plant. Id. The average net plant of all the proxy water utilities is approximately $2.45 billion in net plant. Id.

Dr. Zepp has studied and quantified the cost of equity differential between small Class A water utilities, and large Class A water utilities. MW Ex. 9, internal Exhibit_(TZ-1), p. 1. It is nearly 100 basis points. Id.

The proxy water utilities used in the DCF analyses have an average S & P credit rating of A+. MW Ex. 9, internal Exhibit(TZ-1), p. 15. The lowest S & P credit rating for the proxy companies is A-, the highest AA-. Id. Although Park consolidated does not have a published credit rating, it would have a Triple B rating under the S & P rating criteria. Rebuttal Testimony of Leigh Jordan, MW Ex. 7 at pp. 18-20. The coupon rates that Park obtains for its debt issues are consistent with a Triple B rating, both before and after the acquisition of Park by a Carlyle Group infrastructure fund. Id. The California Commission has specifically found that Park consolidated has the equivalent of a Moody's Baa rating, which is the equivalent of a Triple B in the S & P rating system. Id.

Dr. Wilson's DCF analysis stopped at a determination of the average result for the proxy water utilities. He made no attempt to measure or determine the risk differential between the subject of his DCF analysis, Mountain, and the average DCF result for his proxy companies. Without any empirical evidence to back his opinion, he simply proffered the average result of his proxy companies and chanted the word - " Carlyle."[10] He did so knowing that Carlyle's cost of capital would be higher than Mountain's cost of capital. Tr. 310. That is one reason why his own cost of capital studies don't support his hypothesis that the acquisition of Park by a Carlyle Group infrastructure fund lowered Mountain's cost of equity capital.

E. Mountain's regulatory risk in Montana is higher than in California.

The MCC has taken an opportunistic view of Park's rate case proceeding in California. When Dr. Wilson filed his Direct Testimony in this case in January, he cited the advocacy position of the Division of Ratepayer Advocates ("DRA") in that proceeding as proof that Mountain's cost of equity capital had declined to 8.75%. In fact, he seemed to specifically tie his recommendation in this docket to the California rate case:

> I would recommend an ROE allowance in this case of 8.75 per cent. This is the same recommendation that was made by the California Commission Staff in Park's recent California rate of return proceeding.

MCC Ex. 1 at 27.[11] Because of the unusual length of time it has taken the Commission to process this case, we know that the California Commission determined that Park's cost of equity capital, post Carlyle, was **not** 8.75% but 9.79%. Suddenly, in the eyes of the MCC, the California proceeding is irrelevant. Response Brief at 13.

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[10] The MCC goes to great lengths in its brief to argue that Carlyle represented to the Commission that it would provide lower cost capital to Mountain. Mountain witness Jordan showed in his Sur-Rebuttal testimony at pages 3-11 how Dr. Wilson repeatedly mischaracterized both the issues and the testimony in PSC Docket D2011.1.8.

[11] Dr. Wilson's explicit tie to the advocacy of the DRA is one of the reasons his recommendation doesn't tie to his own cost of capital studies.

A California Commission decision that the cost of equity for Park is 9.79% is consistent with a determination by this Commission that the cost of equity capital for Mountain is 10%. On a comparative basis, the regulatory risks of Mountain in Montana are high when compared to the regulatory risks of Park in California. MW Ex. 7 at p. 8; MW Ex. 8 at pp. 27-29. California uses a fully projected test year, while this Commission uses a historic test year. *Id.* This Commission's decision in this docket will determine whether Mountain will even be allowed to reflect health insurance premiums that have been paid for the last nine months in rates which haven't as of yet been established. The California Commission has authorized a WRAM for Park, a rate-making tool which it determined reduced Park's cost of equity capital by 25 to 30 basis points. MW Ex. 7 at 7; tr. 186-187, 225.

F. <u>If Dr. Wilson's cost of capital studies had been properly conducted, they would have shown a higher cost of equity capital.</u>

Dr. Zepp, in his rebuttal testimony, showed in great detail how Dr. Wilson had crafted his DCF studies with an eye towards creating a downward bias in their results. MW Ex. 9. He explained how Dr. Wilson failed to complete his DCF analysis by comparing the relative risks of Mountain compared to the proxy companies used in the DCF analysis. MW Ex. 9 at p. 6. He explained how Dr. Wilson failed to calculated the dividend yields correctly. MW Ex. 9 at pp. 10-11. He explained how Dr. Wilson's "Fundamental DCF" improperly truncated the formula for implied growth by eliminating the "sv" component from "g=br + sv". MW Ex. 9 at 17-19. He also addressed the flaws in Dr. Wilson's CAPM analysis. MW Ex. 9 at pp. 20-24. He restated Dr. Wilson's cost of capital studies to eliminate Dr. Wilson's biases. MW Ex. 9, internal Exhibit_(TZ-1) at p. 16. The restated studies indicated that average cost of capital for the proxy companies was between 10.4% and 10.7%, <u>before</u> addressing the risk of Mountain relative to those companies. MW Ex. 9, at p. 29, internal Exhibit_(TZ-1) at p. 16.

G. Mountain's Cost of Equity Capital is an Opportunity Cost.

The cost of capital to be determined by the Commission in this case is an opportunity cost. MW Ex. 10 at pp. 3-4. Contrary to the assertions of the MCC in this case, both the applicable legal standards and common sense dictate that is the character of the investment which drives the return requirement, not the identity of the investor. The MCC hypothesis mocks its own cost of capital studies. If it is the identity of the stockholder that is controlling, instead of the nature of the enterprise, why did the MCC use publicly traded water utilities as the proxy companies in its cost of capital studies?

CONCLUSION

The Commission should determine that Mountain's cost of capital is at least 10%. Its decision final order in this case should also reflect the current cost of health care insurance in rates.

Dated this 16th day of September 2013.

HUGHES, KELLNER, SULLIVAN & ALKE

By John Alke

John Alke
40 W. Lawrence, Suite A
P. O. Box 1166
Helena, MT 59624-1166

ATTORNEYS FOR MOUNTAIN WATER

CERTIFICATE OF SERVICE BY MAIL

I HEREBY CERTIFY that a copy of the foregoing **REPLY BRIEF** was served upon the following by electronic means and mailing a true and correct copy thereof on **September 16, 2013**, addressed as follows:

SUZANNE SNOW
MONTANA CONSUMER COUNSEL
P O BOX 201703
HELENA MT 59620-1703
ssnow@mt.gov

JIM NUGENT
CITY OF MISSOULA
CITY ATTORNEY'S OFFICE
435 RYMAN STREET
MISSOULA MT 59802
JNugent@ci.missoula.mt.us

MONICA J. TRANEL
TRANEL LAW FIRM, P.C.
GREAT NORTHERN TOWN CENTER - EMPIRE BLOCK
30 W 14TH STREET, SUITE 204
HELENA MT 59601
Mtranel@tranelfirm.com

John Alke
____
John Alke

PSC-060

Regarding: Adjustment for $57,438
Witness: Kappes

a. Please detail the derivation of the $57,438 adjustment proposed by Schulz of the MCC. Pages 4-5 of his testimony show an adjustment proposal of $36,763 for MWC and after allocation, an adjustment of $7,497.

The original rate case application contained a requested adjustment of $36,763 for medical insurance premiums based on an estimated increase of 10% for 2013 premium expense. The following table was submitted in support of this adjustment as part of the work papers that accompanied the filing.

		Insurance Type	sc		
Coverage Type D	Data	Medical	Dental	Vision	Grand Total
Employee Only	Sum of CountOfCoverage Type	10	12	10	32
	Sum of Ee Cost	46.07	10.25	0.66	56.98
	Sum of Ee Annual Cost	5,528.40	1,476.00	79.20	7,083.60
	Sum of Er Cost	395.43	28.59	7.97	431.99
	Sum of Er Annual Cost	47,451.60	4,116.96	956.40	52,524.96
Employee & Spouse	Sum of CountOfCoverage Type	8	8	8	24
	Sum of Ee Cost	231.49	23.27	2.34	257.10
	Sum of Ee Annual Cost	22,223.04	2,233.92	224.64	24,681.60
	Sum of Er Cost	739.79	52.77	11.08	803.64
	Sum of Er Annual Cost	71,019.84	5,065.92	1,063.68	77,149.44
Employee & Child	Sum of CountOfCoverage Type	5	5	5	15
	Sum of Ee Cost	169.69	19.17	5.08	193.94
	Sum of Ee Annual Cost	10,181.40	1,150.20	304.80	11,636.40
	Sum of Er Cost	624.99	45.15	16.19	686.33
	Sum of Er Annual Cost	37,499.40	2,709.00	971.40	41,179.80
Employee & Family	Sum of CountOfCoverage Type	15	16	15	46
	Sum of Ee Cost	370.57	34.72	5.08	410.37
	Sum of Ee Annual Cost	66,702.60	6,666.24	914.40	74,283.24
	Sum of Er Cost	998.05	74.02	16.19	1,088.26
	Sum of Er Annual Cost	179,649.00	14,211.84	2,914.20	196,775.04
None	Sum of CountOfCoverage Type	7	4	5	16
	Sum of Ee Cost	-	-	-	-
	Sum of Ee Annual Cost	-	-	-	-
	Sum of Er Cost	-	-	-	-
	Sum of Er Annual Cost	-	-	-	-
Total Sum of CountOfCoverage Type		45	45	43	133
Total Sum of Ee Cost		817.82	87.41	13.16	918.39
Total Sum of Ee Annual Cost		104,635.44	11,526.36	1,523.04	117,684.84
Total Sum of Er Cost		2,758.26	200.53	51.43	3,010.22
Total Sum of Er Annual Cost		335,619.84	26,103.72	5,905.68	367,629.24
Pro-Forma Premium Increase for 2013					10.00%
Pro-Forma Premium Expense--Health and Dental Insurance					**$ 404,392**

The balance of the $57,438 amount is $20,675. This was the amount submitted on data request PSC-048 as an addition to the projected medical insurance premium once the final insurance renewal negotiations were almost complete. The final increase was then estimated at 15.62% rather than 10%. The following table is a revision to the exhibit above with the 15.62% increase factored in. The difference between the annual cost at the bottom of the table of $367,629 and the Pro-Forma Premium Expense line item total of $425,067 is $57,438.

		Insurance Type sc			
Coverage Type D	Data	Medical	Dental	Vision	Grand Total
Employee Only	Sum of CountOfCoverage Type	10	12	10	32
	Sum of Ee Cost	46.07	10.25	0.66	56.98
	Sum of Ee Annual Cost	5,528.40	1,476.00	79.20	7,083.60
	Sum of Er Cost	395.43	28.59	7.97	431.99
	Sum of Er Annual Cost	47,451.60	4,116.96	956.40	52,524.96
Employee & Spouse	Sum of CountOfCoverage Type	8	8	8	24
	Sum of Ee Cost	231.49	23.27	2.34	257.10
	Sum of Ee Annual Cost	22,223.04	2,233.92	224.64	24,681.60
	Sum of Er Cost	739.79	52.77	11.08	803.64
	Sum of Er Annual Cost	71,019.84	5,065.92	1,063.68	77,149.44
Employee & Child	Sum of CountOfCoverage Type	5	5	5	15
	Sum of Ee Cost	169.69	19.17	5.08	193.94
	Sum of Ee Annual Cost	10,181.40	1,150.20	304.80	11,636.40
	Sum of Er Cost	624.99	45.15	16.19	686.33
	Sum of Er Annual Cost	37,499.40	2,709.00	971.40	41,179.80
Employee & Family	Sum of CountOfCoverage Type	15	16	15	46
	Sum of Ee Cost	370.57	34.72	5.08	410.37
	Sum of Ee Annual Cost	66,702.60	6,666.24	914.40	74,283.24
	Sum of Er Cost	998.05	74.02	16.19	1,088.26
	Sum of Er Annual Cost	179,649.00	14,211.84	2,914.20	196,775.04
None	Sum of CountOfCoverage Type	7	4	5	16
	Sum of Ee Cost	-	-	-	-
	Sum of Ee Annual Cost	-	-	-	-
	Sum of Er Cost	-	-	-	-
	Sum of Er Annual Cost	-	-	-	-
Total Sum of CountOfCoverage Type		45	45	43	133
Total Sum of Ee Cost		817.82	87.41	13.16	918.39
Total Sum of Ee Annual Cost		104,635.44	11,526.36	1,523.04	117,684.84
Total Sum of Er Cost		2,758.26	200.53	51.43	3,010.22
Total Sum of Er Annual Cost		335,619.84	26,103.72	5,905.68	367,629.24
Pro-Forma Premium Increase for 2013					15.62%
Pro-Forma Premium Expense--Health and Dental Insurance					**$ 425,067**

The amount of $7,497 shown on Mr. Schulz' testimony relates to the equivalent adjustment for Main Office. On the exhibit accompanying PSC-048 under the heading "Park Water Co. – Main Office, Data Request for PSC-048", adjustment (c) shows an amount of $24,654 that reflects the actual 2013 premium increase. Applying the Main Office allocation factor of 30.41% to that amount results in an expense adjustment of $7,497.

b. Would not the adjustment for known and measurable changes be the total expense paid in 2012 (i.e., the last payment for 2012 and the first installment for 2013 that was included in the pay period of December 17-30, 2012)? Please explain.

Mountain believes that the proper pro-forma expense for medical and dental insurance is the annualized 2013 premium expense, which was known and measureable with certainty by October 2012. The documents legally binding the employees to their benefit elections were signed and submitted to Mountain and Park by early November. Those documents defined the required employee contributions for the 2013 premium period, thus obligating the employer to the balance of the premium expense. The first installment of the employee portion of the 2013 premiums was withheld from employee pay during the pay period of December 17-30, 2012. At that point, the increased level of expense was in effect.

Ratemaking is forward-looking. One of its objectives is to determine a level of expense that is representative of utility operations and then to properly match that expense with a revenue requirement. On a going-forward basis, health insurance expense is most appropriately determined by using premium rates that went into effect at the end of 2012.

APPENDIX 1-2

c. What would be the expense be using the above parameters?

The total 2012 expense would be $367,629.

APPENDIX 1-3