

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

\* \* \* \* \*

IN THE MATTER OF the Joint Application of ) REGULATORY DIVISION  
Liberty Utilities Co., Liberty WWH, Inc., )  
Western Water Holdings, LLC, and Mountain ) DOCKET NO. D2014.12.99  
Water Company for Approval of a Sale and )  
Transfer of Stock )

**DATA RESPONSES OF THE MONTANA CONSUMER COUNSEL  
TO THE MONTANA PUBLIC SERVICE COMMISSION  
(PSC-041 THROUGH PSC-049)**

PSC-041

Regarding: Carlyle Cost of Equity/Capital Structure, PSC Jurisdiction  
Witness: Wilson

- a. In PSC Docket No. D2012.7.81, Order No. 7251c, ¶ 34, the PSC approved an ROE for Mountain Water of 9.8%. The Order also noted that the California Utilities Commission had recently approved an ROE of 9.7% (¶ 36). Please explain the statement on pp. 6-7 and p. 14 of your testimony that Carlyle's equity capital has a Commission-authorized cost of more than 16% (including income tax allowance).
- b. The PSC, in the same Order referenced in part (a), approved the Park Water debt/equity capital structure for Mountain Water of 43.88% debt and 56.12% equity (the capital structure was not contested). If the acquisition cost savings were flowed through to ratepayers, what would be the resulting Park Water capital structure?
- c. Please provide documentation for the statement on p.7 of your testimony that pass-through of finance cost savings is a fundamental standard of cost-of-service regulation.
- d. Please explain the statement in footnote 4 and p. 17 of your testimony concerning the immediate abandonment of cost-of-service regulation. In what manner is cost-of-service regulation being abandoned?

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- e. If the acquisition premium was not immediately flowed through to ratepayers, what would prevent the Montana PSC from requiring a rate case filing to recover the premium for ratepayers through a reduction in authorized return based on a significant shift in capital structure, thus decreasing rates?

**RESPONSE:**

- a. As stated in Dr. Wilson's testimony, Carlyle's equity capital has a Commission-authorized and ratepayer-funded cost of more than 16 percent (including income tax allowance). As further explained: Pre-tax cost of capital allowance = post-tax ROE/1-tax rate. With a PSC approved post tax ROE for Mountain Water of 9.8% and a combined federal /state tax rate of approximately 40% the pre-tax cost of capital=  $9.8\%/1-0.4 = 16.33\%$ .
- b. Conditioning any approval of the proposed acquisition by requiring that rate payers be credited with acquisition cost savings would not, itself, change the ratemaking capital structure. It would simply recognize the acquisition-enabled cost of service reduction with a monthly bill credit and prevent the acquisition from undermining cost-of service ratemaking.
- c. The Montana Supreme Court has found and consistently applied the principle of matching rates and costs. See *Mt. Water Company v. Mont. Dep't of Public Serv. Regulation*, 254 Mont. 76, 79 (Mont. 1992), in which the Court noted:

In Montana, public utility rates are set to match utility costs during the period that rates are in effect. The utility, the Montana Consumer Counsel, the PSC, or other persons with standing may seek a rate change when the financial information indicates a mismatch. See § 69-3-301, MCA et seq.

Dr. Wilson's testimony is that pass-through of acquisition cost savings is essential in order to preserve the fundamental regulatory standard of cost-of-service regulation. In contradiction of these cost-of-service principles, it is apparently APUC's strategy in this case to retain these finance cost savings for its own benefit so as to enhance profits and to fund the substantial acquisition premium that Algonquin proposes to pay Carlyle. Although the Company has said that it does not intend to recover its Carlyle acquisition premium from Montana ratepayers, Algonquin's plans for financing the acquisition without

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passing through the merger-related finance cost savings to ratepayers is a de facto recovery of the acquisition premium from ratepayers.

Financing costs, including tax loadings, are by far the largest element of costs incurred by capital intensive utilities such as water companies. It is unquestionable logic that the failure to reflect actual finance costs in utility rates would be a fundamental violation of cost-of-service regulatory principles.

- d. Please see the response to part c of this question. It would clearly be a fundamental abandonment of cost-of-service regulatory principles to fail to accurately reflect a major change in the largest element of costs in utility rates.
- e. While there may be nothing that would prevent the Montana PSC from requiring a general rate case filing, that is not necessary and would be a much more complex undertaking involving far more time and many more issues than simply conditioning any acquisition approval by requiring that ratepayers be credited with the obvious known and readily measurable acquisition cost savings.

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PSC-042

Regarding: Capital Structure/Cost of Capital  
Witness: Wilson

- a. How much funding of the Park Water purchase by Liberty/Algonquin is funded through debt and how much is funded through equity?
- b. Do you have an opinion on what the capital structure of Mountain Water would be or should be, were the transaction approved?
- c. What would the required rate of return be for Mountain Water were the transaction approved, assuming the debt cost is as was reported, and assuming that the ROE you last proposed was adopted? *See In re Mountain Water*, Docket. No. D2012.7.81, Order 7251c ¶ 17-19 (Nov. 14, 2013).
- d. Please make the same calculation as in (c), substituting your ROE assumption for the most recently approved ROE. *Id.* ¶ 34.
- e. If this transaction goes through, was do you believe is an appropriate regulatory cost of debt?

**RESPONSE:**

- a. As discussed in his testimony, Dr. Wilson has identified \$35 million of equity funding that is being provided by Emera and \$160 million of 4.1 percent 30-year debt financing that has been raised by APUC. This represents 78 percent of the funds required to purchase Carlyle's equity interest in Park Water.
- b. No such change would be required. Please see response to PSC-041 (b) and to part (e) of this question.
- c. No such change would be required. Please see response to PSC-041 (b) and to part (e) of this question.
- d. No such change would be required. Please see response to PSC-041 (b) and to part (e) of this question.
- e. Please see response to PSC-041 (b). I am simply recommending that ratepayers be credited with acquisition cost savings as a condition for

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- f. transaction approval. I am not recommending an unnecessary new general rate case.

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PSC-043

Regarding: Adjustments to Capital Structure and Actual Cost  
Witness: Wilson

If the Commission approved the sale on the condition the reevaluated capital structure and actual cost of debt be incorporated into rates, would your opinion about what the Commission should order in this docket change? Please explain.

**RESPONSE:**

No. Please see the responses above to PSC-041 (b) and (e).

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PSC-044

Regarding: Fitness to Operate  
Witness: Wilson

- a. Please explain the statement on p. 11 of your testimony that Liberty would only be able to receive financial support from Algonquin “if Algonquin has...submitted itself to the regulatory jurisdiction of this Commission with respect to the ownership and operation of Mountain Water.” That is, what would prevent Algonquin from supplying financial support if they were not regulated by the Commission?
- b. Regarding the statement on p. 13 of your testimony that “Algonquin does not propose to pass through or share these substantial cost savings with its water utility ratepayers,” what methods are used to share these cost savings?
- c. Please provide detailed examples of cases where acquisition cost savings have been shared with ratepayers.
- d. What percentage of the referenced \$20 million in annual finance cost savings should be allocated to Mountain Water?

**RESPONSE:**

- a. The issue is one of obligation, not prevention. Dr. Wilson has testified that Liberty is not the corporate treasury to which the APUC public utility operating companies will need to look for financial support from time-to-time. Within the Algonquin corporate family, that kind of support can only come from the parent holding company, which should be subject to MPSC regulatory jurisdiction and demonstrate its own financial and managerial fitness to own and operate this utility in Montana. At this point, despite its obvious role in structuring and controlling the proposed acquisition, Algonquin has resisted every effort to require it to appear as a party to this proceeding.

As discussed in detail in Dr. Wilson’s testimony, it is clear that APUC is the acquiring entity in this case and that APUC will have total financial control over Park Water and Mountain Water. The required financial support for Mountain Water cannot be a matter of discretion to APUC, but a financial obligation pursuant to the regulatory authority of the MPSC.

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- b. The cost savings should be passed through to Mountain Water ratepayers in the form of monthly bill credits.
- c. See, for example, State of Maryland Public Service Commission Order No. 83788 *In The Matter of The Application of The Merger of FirstEnergy Corp. and Allegheny Energy, Inc.*, Issued January 18, 2011 in Case No. 9233, wherein the Maryland Commission said:

“These [sharing] conditions will ensure that Potomac Edison's ratepayers share in the synergies and savings expected to result from the transaction...” Within three months following consummation of the Merger, the Applicants shall pay a lump-sum rate credit totaling \$6.5 million to Potomac Edison's Maryland residential customers. This credit, which will amount to about \$29 for each residential customer, shall be funded by FirstEnergy, not by Potomac Edison.” (Please note that no additional rate case was required to accomplish this pass-through of acquisition cost savings and that the Commission’s Order reflected the necessary regulatory jurisdiction (also required here) over the parent holding company.)

Also see Pennsylvania Public Utility Commission, Re: Joint Application of West Penn Power Company doing business as Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1J02(A)(3) of the Public Utility Code approving a change of control of West Penn Power Company and Trans-Allegheny Interstate Line Company, Docket Nos. A-2010-2176520, A-2010-2176732. JOINT PETITION FOR PARTIAL SETTLEMENT filed October 25, 2010 which stated: “Certain merger savings will be shared with West Penn Residential customers and the Tariff 37 customer over three years beginning 60 days after consummation of the Merger. These savings will be shared by West Penn providing a credit to residential customers' distribution rates totaling \$3.57 million per year for three years, and by West Penn providing a credit to the Tariff 37 customer's distribution rates of \$15,000 per year for three years. (Please note that no additional rate case was required to accomplish this pass-through of acquisition cost savings.)

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Also see Duke Energy' Press release of August 1, 2012, concerning the pass-through of cost savings from the Duke Energy/Progress Energy merger, entitled "Duke Energy Merger Benefits Begin Flowing to Carolinas Customers" which states that "Duke Energy Carolinas and Progress Energy Carolinas, both subsidiaries of Duke Energy Corp., are seeking regulatory approval to begin

returning merger-related savings to customers. Filings made today with the North Carolina Utilities Commission (NCUC) and Public Service Commission of South Carolina (PSCSC) are a significant first step in the company's promise to deliver \$650 million in [merger cost]savings to customers over the next five years. The filings propose total customer rates be reduced by around \$70 million over the next 12 months..."

- d. Dr. Wilson has not calculated this percentage. It could be done in proportion to Mountain Water's revenues as a percentage of total Park Water revenues or in proportion to net plant investment.

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PSC-045

Regarding: Fitness to Operate  
Witness: Wilson

Is it the testimony of the MCC that the estimated \$20 million in actual finance cost savings is sufficient to allow for a \$20 million acquisition premium for that would otherwise not be available? As a result, will Liberty/Algonquin be in essence charging an additional \$20 million in annual rates to Mountain Water ratepayers than would otherwise be permissible?

**RESPONSE:**

It is Dr. Wilson's testimony that water utility financing costs will be reduced by approximately \$20 million annually in the event that APUC/Liberty acquires Mountain Water. Pursuant to just and reasonable cost-of-service ratemaking, this cost reduction should be passed through to ratepayers in monthly bill credits going forward. Without this pass-through of cost savings Park Water ratepayers, including Mountain Water ratepayers would be charged \$20 million per year in excess of APUC's actual cost of service.

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PSC-046

Regarding: Fitness to Operate  
Witness: Wilson

Your direct testimony objects strongly to the structure of the sale of Mountain Water Co. to Liberty. Do you also object to Liberty's ability to run the utility's daily operations given the company's statement to retain all Mountain Water Co. employees for at least five years (see Direct Testimony of Michelle Halley)?

**RESPONSE:**

This question does not accurately reflect my testimony. My testimony does not deal with issues concerning the capability of Mountain Water Company employees, but with matters concerning financial obligations, regulatory control and corporate accountability.

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PSC-047

Regarding: Fitness to operate  
Witness: Wilson

On pages 9-11 of your Testimony, you identify a fitness to operate problem with Algonquin's absence in this proceeding. In Order 7392n of this Docket, the Commission stated:

In past proceedings, the Commission considered whether a parent's proposed ownership of a subsidiary presents the likelihood that the subsidiary's capital structure will deteriorate and become unacceptably leveraged. [*In re Babcock & Brown Infrastructure*, Docket. No. D2006.6.82, Or. 6754e p. 48 (Jul. 31, 2007).] While the Commission has been able to make this determination in part by reviewing a proposed parent corporation's financial projections, *id.*, a proposed parent's active participation and voluntary presence increase the chances that it will meet its burden of proof under the public interest standard, the no-harm to consumers standard, or the net-benefit to consumers standard. The involvement of parent corporations in sale and transfer dockets will continue to bear on the applicant's burden of proof when personal jurisdiction over that parent corporation is lacking.

Order 7392n ¶ 47 (Sept. 24, 2015). Do you agree with this conclusion and do you see this as an adequate treatment of the problem you have identified in your testimony?

**RESPONSE:**

My testimony goes well beyond the matters addressed in this quotation from Order 7392n. I have testified at the pages cited that it is clear that APUC is the real acquiring entity in this case. I have shown that APUC has arranged and controlled virtually all of the funding and organization for the acquisition of Park Water (and Mountain Water). I have further testified that despite its obvious role in structuring and controlling the proposed acquisition, Algonquin has resisted every effort to require it to appear as a party to this proceeding.

Relatedly, I have shown that APUC has entered into a Strategic Investment Agreement with Emera, a larger Canadian holding company, under which Emera

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is supplying capital “in support of the acquisition by APUC of Park Water Company in Montana.” As a consequence of this Strategic Investment Agreement, Emera has become the largest and controlling owner of APUC. While

these are matters of concern to Montana ratepayers that should be fully evaluated by the Commission in addressing the merits of this proposed acquisition and fitness to serve issues in this case, they have not even been disclosed, let alone addressed, in the Company’s application, and there has been no opportunity to investigate them.

In addition to requiring regulatory jurisdiction over APUC, the Commission should require the provision of the Strategic Investment Agreement under which Emera is financing APUC’s acquisition of Park Water Company in Montana. Since the filing of my testimony in this case I am informed that the standstill agreement that had limited Emera’s ownership of APUC to 25 percent has been or is being removed so that Emera may acquire APUC ownership without limit. These are relevant matters that should be revealed and investigated in this case.

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PSC-048

Regarding: Ring-fencing  
Witness: Wilson

- a. What ring-fencing conditions should the Commission impose, were it to grant the application?
- b. Why are the ring-fencing conditions already imposed on Mountain Water, after its upstream owner became Carlyle, insufficient? *See In re Mountain Water*, Docket. No. D2011.1.8, Order 7149d ¶¶ 58-70 (Dec. 14, 2011).
- c. Would ring-fencing requirements similar to those imposed on Energy West Montana, Energy West, Inc., and Gas Natural, Inc. in other dockets be sufficient here; if not, why not? *See, e.g. In re EWI Bank of America Financing Approval*, Docket. No. 2014.9.87, Order 7376b (Jul. 7, 2015).

**RESPONSE:**

- a. Specific ring-fencing conditions should be designed after the information indicated in response to PSC-047 has been obtained and evaluated.
- b. They are very likely insufficient because of the unique features of the APUC organization and its apparently aggressive efforts to limit the transparency of information available to regulators and consumers. Further, the role of Emera regarding APUC's future may very well warrant additional specific conditions.
- c. They may be a place to start, but see response to part (b) of this question.

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PSC-049

Regarding: Access to Company's Acquisition Analysis  
Witness: Wilson

- a. On page 23 of your testimony you state that the company has acknowledged that its financial model "is simply some Excel spread sheets." Where specifically has the company made this statement?
- b. Having not accessed the company's acquisition analysis, as you acknowledge on page 25 of your testimony, are you in a position to judge whether or not the company's acquisition analysis "is simply some Excel spread sheets?"
- c. You testify on page 25 of your testimony that that you made the choice not to access the financial model, even though it was made available to you, because you would be subjected to "severely limited ability to communicate with the MCC... about the results of [your] evaluation." In what manner would your communications with the MCC about the financial model be limited? Was such a restriction included in a Commission order?
- d. Should the lack of transparency that you allege in your testimony regarding the financial model be considered a burden of proof issue?
- e. You testify on page 27 of your testimony that you chose not to view the company's modeling because some of what you attempted to portray in your testimony would have constituted "an improper disclosure of information." Are you aware that the City's experts viewed the modeling and submitted testimony on the same?

**RESPONSE:**

- a. This information was provided in various forms from APUC including from its counsel, Mr. Green. It was also stated in the Company's supplemental response to MCC-010 that the Company would provide "an Excel Workbook containing Liberty's confidential financial model."
- b. See response to part (a) of this question.
- c. Dr. Wilson testified that "Liberty offered to provide me with electronic access to APUC's acquisition model over the internet to a Company computer at the

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- d. offices of its attorney in Helena and, as I understand it, with certain restrictions such as no copying, no printing, no ability to save my work other than on

APUC's network, and severely limited ability to communicate with the MCC and within this proceeding generally about the results of my evaluation. Given these restrictions, Dr. Wilson felt that he had no choice but to decline access.

I was not comfortable accepting access to the model under these conditions for several reasons. First, with due respect to the Commission's rulings on the discovery issues surrounding the Company's financial model, the conditions ultimately adopted by the Commission would, in my view, provide APUC and its attorneys with unreasonable opportunities for surveillance, observation and access to my thought processes and my interaction with the Consumer Counsel. These thoughts and interactions concern theories, mental impressions and case strategies, which drive the evolution of my evaluation.

Second, no aspect of public utility regulation requires greater transparency than financing. Restricting access to such fundamental information in this way would be the antithesis of the essential purpose of public utility regulation.

Third, the assumptions and conclusions of the Company's modeling have been substantially disclosed, and indeed publicized, by the Company in other forums.

Direct proof of the Company's own internal deliberations on structuring the acquisition which suitable access to its financial model might have provided would, of course, be a desirable enhancement to the Commission's deliberations. However, the proof provided by the Company's public pronouncements is more than sufficient, in my view, to establish what needs to be established in this case about the adverse impact of the Company's structuring of its acquisition on the public interest.

Finally, I believe that, had I accepted access to the Company's modeling as offered, some may have attempted to portray what I have reported here as an improper disclosure of information acquired by means of that access. In

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short, it was my judgment, as an economist, that the terms of access offered entailed a prohibitively high price for little likely benefit.

This testimony fully explains why Dr. Wilson concluded that communications with the MCC about the financial model would be limited.

- e. The answer to this question would seem to be a legal matter.
  
- f. I did not testify that I chose not to view the company's modeling because some of what I attempted to portray in my testimony would have constituted "an improper disclosure of information." To the contrary, I testified that I believed that, "had I accepted access to the Company's modeling as offered, some may have attempted to portray what I have reported here as an improper disclosure of information acquired by means of that access." Given the restrictive conditions offered, I felt that there was no choice to be made other than the Hobson's "take it or leave it" which was unacceptable.

It is my understanding that the City's experts viewed the modeling and submitted testimony. However, I have not seen that testimony.