

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

IN THE MATTER OF the Investigation of
the Montana Public Service Commission
into whether Mountain Water Company's
rates are Just and Reasonable

REGULATORY DIVISION
DOCKET NO. D2016.2.15

CITY OF MISSOULA'S POST-HEARING BRIEF

The mandate given to the Public Service Commission is absolutely clear. “[T]he PSC must authorize utility rates sufficient to cover the utility’s cost of debt and cost of equity, **but no more**, or the utility’s customers will be paying excessive rates for the services the utility provides.” *Mountain States Telephone and Telegraph Co. v. Department of Public Service Regulation*, 191 Mont. 331, 334 (1981) (emphasis added).

There is no doubt – despite Liberty Utility Co. and Algonquin Power and Utilities Co.’s (“Liberty/Algonquin”) shell games and obfuscation – that Mountain Water Company’s cost of debt has substantially decreased since the unauthorized transfer of the utility. The Public Service Commission (“PSC”) must impose a corresponding decrease in rates to fulfill its duty. Failure to act promptly and decisively would only reward Liberty/Algonquin for thumbing its nose at the Commission, at the expense of both current Missoula ratepayers and ratepayers of other utilities who are sure to be emboldened by Liberty/Algonquin’s example.

I. Mountain Water's decrease in capital costs under Liberty/Algonquin ownership is definite and substantial.

Missoula consumers are paying rates based on Carlyle's capital costs, which were more than 16 percent. See Direct Testimony of John W. Wilson, pp. 8-9. The 16 percent capital cost is undisputed. Mountain Water's expert, Thomas Bourassa, testified before this commission:

Q: You suggested to the Commission that you agree with Dr. Wilson's math on the 16 percent, did you not?

A: Well, that was an equity cost.

* * * * *

Q: You admit, though, that the 16 percent is embedded in the rates that ratepayers pay today.

A: I don't dispute that.

Trans. 274:11-14; 274: 23-25 (May 3, 2016).

Recognizing that any decrease to the cost of the utility's capital would increase the portion of Missoula water consumers' bills that go to corporate profit, the PSC was rightly concerned by Liberty/Algonquin's illicit assumption of ownership. Appropriately, the PSC initiated this investigation to determine whether the rates remain just and reasonable, or extract excessive profit from ratepayers. Despite Mountain Water's determined resistance to providing information, the PSC's investigation proved the utility's cost of capital has indeed decreased dramatically from the 16 percent on which rates are still based.

a. Course of the Investigation.

At the outset of this investigation, the PSC demanded information from Mountain Water regarding the new cost of debt associated with Liberty/Algonquin's unauthorized acquisition of the utility. (*See* Data Request PSC-001(b).) Mountain Water dodged the question, instead explaining that it made the purchase with \$235 million from a term credit facility, but intended to refinance the debt prior to July 2017. The PSC pressed the issue, demanding "the associated cost of debt, i.e. the interest rate" on the money used to finance the acquisition. (*See* Data Request PSC-009(b).) Mountain Water again evaded the direct question, once more discussing instead its plans to refinance by July 2017 at some unknown future rate.

In response, the PSC voted to compel an answer to its question. (*See* Order 7475g.) Mountain Water responded by offering to file its loan documents under seal but claimed that on March 9, 2016—a week after the PSC voted to compel an answer on cost of debt—Liberty had suddenly "retired the Term Loan Agreement on its books through an infusion of equity," so the debt was no longer on Liberty's books. (*See* Mountain Water's Supplemental Response to PSC-009(a).)

Following up yet again, the PSC inquired into this abrupt "retirement" of debt, 16 months prior to the July 2017 deadline Mountain Water had previously discussed. Mountain Water responded that "an intermediate holding company parent" of Liberty had assumed the loan, discharging Liberty's debt. (*See* Mountain Water's Response to PSC-017(b).) This is part of the same shell-game strategy on which Algonquin/Liberty has relied the past 18 months, and leaves little doubt that Liberty had something more to hide from the PSC.

b. Liberty/Algonquin rates are far lower than Carlyle's.

Despite Mountain Water's evasion of the PSC's Data Requests, the Commission has proof positive that the cost of capital has fallen dramatically under Liberty/Algonquin. That rate remains under seal and unavailable to the public, unless and until the PSC grants the Montana Consumer Counsel's Motion to unseal the documents and give the public full access to the information. But even without the sealed documents, it is clear the cost of capital has plummeted. Algonquin's 2016 SEC Report, filed March 16, 2016, avers that the interest rate on \$160 million in debt intended to finance the purchase of Park Water was 4.13 percent. This debt was replaced or refinanced with the \$235 million short-term debt described in Mountain Water's Response to Data Requests. It is logical to infer that Liberty/Algonquin refinanced at a rate even lower than 4.13 percent, and in fact Mountain Water's expert, William Killeen, confirmed in his testimony that the actual rate is *much* lower.

Ultimately, the PSC's investigation confirmed what it suspected at the outset. The cost of capital associated with Mountain Water dropped from 16 percent all the way down to 4 percent, or lower. As a direct result, profit gleaned by Mountain Water's owners—from Missoula consumers beholden to the monopoly—has skyrocketed. This is undisputed.

c. The best evidence establishes that rates are no longer just and reasonable.

For four months, Mountain Water Company has been operating under a fiction. The fiction—that Missoula ratepayers must all pitch in to subsidize a high cost of capital—is based on outdated and unreliable evidence. Specifically, the 16 percent rate

of return was calculated in 2011 based on hypotheticals assumed to be applicable to Carlyle. It was imprecise as applied to Carlyle in 2011, and it is abjectly wrong as applied to Liberty/Algonquin in 2016.

Fortunately, better evidence is available. The documents filed by Liberty in response to the PSC's Order to Compel provide the actual, precise interest rate on the capital used to acquire Mountain Water. Should consumers' water bills be based on imprecise and outdated hypotheticals, or recent and exact figures produced to the PSC? Here, common sense and the Montana Rules of Evidence agree: we should rely on the best evidence. Montana Rule of Evidence 1002, commonly known as the "best evidence" rule provides:

To prove the content of a writing, recording, or photograph, the original, writing, recording, or photograph is required, except as otherwise provided by statute ...

Here, the best evidence of Mountain Water's cost of capital under Algonquin is Liberty's own (reluctant) response to the PSC's data requests. That is the evidence that should be used to set rates.

II. The PSC must take some action to fulfill its mandate.

It is undisputed that Mountain Water is currently collecting payments based on a 16 percent cost of capital. The best evidence available proves that its actual cost of capital is 4 percent or lower. Because the PSC previously established that rates were just and reasonable when the cost of capital was 16 percent, it is self-evident that rates are not just and reasonable when the cost of capital is far below 16 percent. All that remains for the PSC to decide is how to respond.

Mountain Water would have the PSC do nothing, at least until it requests another rate increase (which President John Kappes assured everyone it will do early and often). Presumably Mountain Water hopes its “punishment” will consist merely of receive a smaller increase than it requests. In the meantime, and even after, Mountain Water/Liberty/Algonquin will continue to profit from their contempt for the PSC’s approval, gradually recouping the stupendous acquisition premium that seemed so illogical before the PSC’s investigation. Not only would this be unfair and unjust to Missoula ratepayers who have no other choice for drinking water, it will set a precedent sure to be noticed by other utility owners; it pays to ignore the PSC.

This is contrary to the PSC’s duty to set rates “sufficient to cover the utility’s cost of debt and cost of equity, but no more” in order to protect customers from excessive rates for an essential service. *Mountain States*, 191 Mont. at 334.

a. The PSC could adopt one of Dr. Wilson’s suggested remedies.

Dr. John Wilson, on behalf of the Montana Consumer Counsel, has provided sound recommendations for potential remedies. Dr. Wilson explained that one option is for the PSC to apply a rate adjustment that takes into consideration the actual cost of capital and the return on investment enjoyed by the parent company.

The Montana Supreme Court has held that it is permissible and correct for the PSC to apply an adjustment to reflect the reality of a parent/subsidiary structure like Mountain Water/Liberty Algonquin. In fact, in *Mountain States*, the Court held that without this adjustment the parent company’s stockholders would collect an “**unconscionable and excessive** return...” (emphasis added).

Here, the facts, already proven, support application of a permanent rate adjustment to reflect the change in upstream ownership. In Order 7392n, the PSC recognized that “Algonquin has complete ownership over Liberty and derives the benefits of Liberty’s profits.” ¶ 42. Liberty has full ownership (or at least full access to the revenue) of Mountain Water. It is entirely appropriate for the PSC to revise the rate of return to account for the unconscionable and excessive returns Algonquin is recovering through multiple levels of ownership and leveraging. Specifically, Dr. Wilson advised that the PSC could reduce Mountain Water customers total rates by \$6.127 million annually (out of a company valued in terms of a rate base at \$259 million). This would reflect the amount of savings under Algonquin/Liberty’s lower cost of capital that is attributable to Mountain Water (about 31.81 percent of Park Water’s consolidated capital). That amount could be returned to the consumers who have been forced to overpay as a line-item credit or through a rate reduction.

Additionally, Dr. Wilson advised that the PSC could eliminate the equity component from Mountain Water’s rate of return, resulting in an allowed return rate of 3.68 percent, at least until the Commission formally approves Algonquin/Liberty’s acquisition of Mountain Water and can properly establish a just and equitable rate. This approach would protect consumers by eliminating the excess profits they are currently paying on the equity component, and fairly addresses the unauthorized assumption of ownership by Liberty/Algonquin that deprived the PSC of the ability to properly establish an appropriate return on equity.

Dr. Wilson's recommendations would protect consumers from paying excessive and unjustified rates, prompt compliance from Liberty/Algonquin, and discourage other utility owners from disregarding the PSC in the future.

b. The PSC could fashion an alternative remedy.

While Dr. Wilson offered two reasonable remedies, these are by no means the only possible approaches. The PSC has a chest full of regulatory tools, along with the authority and experience to wield them in crafting whatever remedy it determines is appropriate.

The critical question is not precisely *how* the PSC addresses the excessive rates that have resulted from the fly-by-night transfer of ownership to a foreign corporation. The critical questions are *when* and *how much* the PSC remedies the unjust rates. The City respectfully submits that the answers to those questions should be "immediately" and "completely." To wait, or to do nothing, would punish Missoula consumers and reward corporate misconduct.

c. The PSC should unseal the interest rates on Liberty/Algonquin's cost of capital.

In the May 3 hearing, the Montana Consumer Counsel and the City moved the PSC to remove the protective order from the document that Mountain Water finally gave the PSC in response to the Order to Compel, identifying the interest rate on Liberty/Algonquin's acquisition capital. (*See* Transc. 204:23-206:12.) That motion should be granted.

The Montana Constitution guarantees the public the “right to examine documents or to observe the deliberations of all public bodies or agencies of state government and its subdivisions, except in cases in which the demand of individual privacy clear exceeds the merits of public disclosure.” Mont. Const. art. II, § 9.

“[D]ocuments filed by corporate entities with public agencies, such as the PSC, are presumptively available for access by the public under Montana’s Constitution.” *Great Falls Tribune v. Mont. Pub. Serv. Comm’s*, 2003 MT 359, ¶ 60.

Mountain Water bears the burden of proving that the presumptively-public filing should instead remain hidden from public view. *Id.* They have not and cannot, as there is no legitimate reason to maintain secrecy over an interest rate. In the recent case *Southern Montana Telephone Co. v. Mont. Pub. Serv. Comm’s*, ADV-2015-315, Montana First Judicial Dist., Lewis and Clark County, the District Court affirmed PSC Orders concluding that a utility’s executive salaries were not entitled to a protective order. (*See* Order (April 8, 2016).) There is even *less* justification to maintain secrecy over an interest rate. No individual’s privacy is affected; it is no secret that corporations try to borrow at the lowest rate possible; and disclosure of the specific rate on a particular loan has no significant implications to Mountain Water/Liberty/Algonquin’s competitive interests. In fact, Mountain Water’s expert, William Killeen, acknowledged in his public testimony that the interest rate is “probably around 2 percent, possibly even lower than that.” (*See* Transc. 150:5-12 (May 3, 2016).) Granting the Motion to unseal the loan document would simply confirm the rate and allow the PSC to fashion a temporary rate using exact and public information.

The factors weigh heavily in favor of disclosure. The PSC should honor the public's right to examine documents by granting the Montana Consumer Counsel's motion to unseal the interest rate on the acquisition premium.

Dated this 16th day of May 2016.



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CERTIFICATE OF SERVICE

This is to certify that the foregoing was duly served by mail and email upon the following counsel of record at their addresses this 16th day of May 2016:

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