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

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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

REPLY BRIEF OF THE MONTANA CONSUMER COUNSEL

The Montana Consumer Counsel (MCC) submits its comments, argument and discussion in response to the May 16, 2016, Opening Post-Hearing Brief of Mountain Water Co. (Mountain). In general, MCC submits that Mountain fails to apprehend the nature of the Commission's investigation by urging the Montana Public Service Commission (PSC or Commission) to view this as a general rate case.

As the Commission knows, it began this Investigation to determine whether Mountain's rates to its Missoula customers continue to be just and reasonable following the unilateral, unauthorized closing of the acquisition of Mountain's parent company by Liberty/Algonquin (Algonquin is referred to as "APUC"). The primary impact of this transaction was its impact on Mountain's capital costs—

APUC financed the bulk of the transaction with very low cost debt, which was used to buy out Carlyle's equity interest.

The Commission should recognize the impact of this substantial cost reduction inherent in APUC's low cost refinancing of Carlyle's equity ownership. Ratepayers are no longer paying rates that reflect the actual costs of the company's financing. Since Montana law prohibits the recovery of an acquisition premium, only a reduction of Mountain's rates will remove the cost of the acquisition premium now built into the company's rates.

REVIEW OF MOUNTAIN'S OPENING POST-HEARING BRIEF

A. Mountain Incorrectly Recasts This Proceeding As a General Rate Case.

At page 2, Mountain recites the factual background of this Docket—the closing of Liberty's purchase of Mountain's upstream parent, Western Water Holdings. Mountain omits any discussion of the context of that transaction. At the time, the Commission was in the midst of a case to determine whether the transaction should be allowed, the "fitness" of Liberty (and its upstream owner APUC) to own and control a Montana public utility, and any potential conditions necessary to ensure that the transaction, if allowed, would be in the public interest. Financing is naturally a key issue in such a proceeding and, as has been noted, "(g)enerally, in utility mergers and acquisitions, any acquisition-enabled cost savings are passed through to ratepayers as a necessary condition to gain approval for the acquisition." Ex. MCC-1, page 9. The unilateral closing of the APUC/Liberty transaction while the case was on-going left all of these issues unanswered. The current proceeding is not a general rate case, but a review of the financial impact of the ownership transfer, which the Commission has unfortunately now been forced to conduct separately from other transfer issues.

The Commission has already explicitly recognized this distinction, and Mountain is in error when it asserts that the Commission "initiated this matter as a rate case." Mountain Opening Brief, p. 6. Rather, the Commission clearly initiated this docket to determine if rates are just and reasonable "under the current capital structure and cost of capital now that Liberty Utilities is the new owner," and limited the scope of the docket to those issues, *not* a general rate review. Order No. 7475a, ¶ 3.

In this Investigation regarding financial implications of the acquisition, MCC has presented the testimony and recommendations of Dr. John Wilson to address the issues surrounding the acquisition premium. Dr. Wilson urges the Commission to adjust rates to recognize acquisition-related financing cost savings and to eliminate a back door inclusion in rates of the acquisition premium that would otherwise occur as an inherent consequence of the unauthorized ownership transfer. Dr. Wilson also suggests the possibility that the Commission might renew the fitness investigation. Exhibit MCC-1, p. 17. This would allow the Commission and the parties to obtain a full understanding of the complex corporate structure of Liberty and its numerous parents, and to evaluate and resolve the fitness issue.

Mountain continues to mischaracterize Dr. Wilson's discussion of $250 million of Carlyle equity, indicating that he proposed that the equity of the predecessor owner and the debt cost of Algonquin could be used to "determine an ROE for Mountain". Mountain Opening Brief, p. 2. In reality, Dr. Wilson noted that the transaction had created a substantial premium for Carlyle that was made possible by the very low debt costs that funded the APUC acquisition. Rather than regulating Mountain's return on equity, one possibility that Dr. Wilson suggested was a temporary rate adjustment to substitute the lower debt cost for the equity interest that Liberty purchased until such time as Liberty works with the parties and the Commission to resolve its status as an unauthorized buyer.

Review of public utility acquisitions and mergers by the Montana Commission is common practice. Unauthorized "midnight closings" are unprecedented. Liberty's conduct in this case has wasted an immense amount of time and resources of the Commission and intervening parties. Dr. Wilson proposed a course to resolve the pending issues, such as questioning whether, and to what extent, Missoula customers should share in the savings that result from the acquisition financing.

B. There Is Substantial Record Evidence To Support A Rate Adjustment.

Mountain continues to argue that neither MCC, nor the City of Missoula, has met the burden of proof that the rates set by the Commission when Carlyle owned Mountain and its parents are no longer reasonable. Mountain relies on the section of Montana law that states approved utility rates are *prima facie* lawful (Sec. 69-3-110, MCA), and the 2007 decision in *Qwest Corp. v. Dep't of Pub. Serv. Reg.* 2007 MT 350, 174 P.3d 496. The basic point is that a party challenging an approved rate has the burden of proving that rates are unlawful. In this case, the Commission has placed at issue the lawfulness of Mountain's current rates. MCC believes that, while it may be unclear which party has the burden of proof in an investigation proceeding, the larger question is whether a preponderance of evidence demonstrates the unlawfulness of Mountain's rates. There is abundant evidence in Dr. Wilson's testimony and in the body of data requests that Mountain's capital costs have significantly changed and that rates no longer reflect Mountain's actual costs.

On the issue of capital costs, Mountain insists repeatedly that no party has presented "proper evidence" of Mountain's capital structure or capital costs, Mountain Opening Brief, p.6. But this is not a rate case, and the Commission's routine filing requirements do not apply. In this Investigation, the parties are examining the impacts of the acquisition on capital costs, which would normally be done in the course of a transfer application. If Mountain and Liberty want a rate case, they should file one. Pending that filing, the Commission is within its authority to inquire into the significant impact of the acquisition on Mountain's capital costs, just as it would have done if Mountain/Liberty had not unilaterally terminated that case.

This circumstance is also what distinguishes this case from a "single issue" filing. It is an orphan component of a transfer proceeding. MCC submits that, in the unique circumstances that Liberty has forced upon this Commission, it is appropriate to examine the impacts of the new financing on customers. To fail to do so, would be to tolerate the manipulation of the regulatory process by a party that has displayed minimal concern for its new customers, the community in which it operates and its regulators.

C. Mountain's Source of Capital Arguments Are Misplaced.

Mountain moves on to argue that examination of its financing costs would violate financial theory and legal precedent. Mountain Opening Brief, p. 7. It relies on Mr. Bourassa's testimony that equity is equity, no matter its source,[1] and that the end result of this case must be rates sufficient to cover Mountain's costs. Id, pp. 7-9. It is unfortunate that Liberty has created a situation in which it, the holding company, has vastly reduced costs and now defies the Commission's ability to match those lowered costs with reduced rates. MCC acknowledges, as it did at hearing, that any rate reduction should not reduce revenue to the point that Mountain cannot pay its operating expenses and other costs. Dr. Wilson was asked by Staff Counsel Farkas if, despite his recommendation that the equity holders should receive no return, he believes that rates should "at least leave Mountain Water with enough revenue to cover their operating expenses, their taxes and the depreciation, as well as their debt cost." He responded "Yes, I do." Tran., pages 59-60.

In future cases, in which the Commission may fully investigate this complex holding company structure to determine which entity controls Mountain, and accordingly makes crucial decisions that will impact Missoula customers, a greater range of remedies will be available. Here, there are limits to the ability of the

[1] The Montana Supreme Court considered and rejected this argument that the source of equity funding is irrelevant in *Mountain States Telephone and Telegraph Co. v. Dept. of Public Service Regulation*, 624 P.2d 281 (1981). Mountain Bell argued that the PSC's double leverage adjustment violated the "principle that the source of funds determines its cost…" 624 P2d, 485. The Court rejected this argument and affirmed the PSC, noting that "the PSC applied the 'double leverage' adjustment to protect Montana ratepayers from paying excessive utility rates…This capital structure was determined by the management of the two companies, not by the rate order of the PSC…*Id.,* 486. In short, Mr. Bourassa's argument that "equity is equity, no matter its source" is not the law in the State of Montana.

Commission to fully recognize the savings created by the unauthorized closing of the acquisition.

Dr. Wilson's first recommendation was to flow Mountain's full share of the very large financing savings to its customers. Exhibit MCC-1, page 27. He also presented an "alternative compromise" that would replace Mountain's equity with the cheap debt used to buy out Carlyle's equity. This adjustment would credit ratepayers $2.445 million per year, leaving Liberty and its family of companies to retain $3.682 million per year. Exhibit MCC-1, page 24.

D. Single Issue Ratemaking.

Mountain continues to complain about single issue ratemaking (Mountain Brief, page 9), and that issue was fully addressed in the MCC's Opening Brief. To avoid extended repetition, MCC will simply note that such an approach is appropriate only in unusual circumstances, such as sale and acquisition reviews. Ownership transfers, such as this, inherently and fundamentally implicate financing costs and related impacts on acquisition premiums. The Commission has the power to examine a limited set of accounts, and MCC urges it to continue to use that power sparingly since a full rate case provides a much better picture of a utility's financial performance.

This case is exceptional. Mountain and its new parents have left the Commission virtually no choice but to examine their financing costs in order to eliminate from rates a massive acquisition premium. They should not be permitted to recast this transfer-related investigation as a "rate case," and hide behind the Commission's traditional avoidance of the single issue approach. Mountain insists that the Commission must justify its departure from precedent on this issue. Mountain Brief, page 9. There really is no departure from precedent in the context of transfer proceedings, and justification for the Commission's Investigation exists in the unauthorized closing of a transaction before the Commission has had the opportunity to determine whether, and to what extent, customers should participate in the savings that result from that acquisition.

E. The Record Supports A Finding Of Substantial Acquisition Related Savings.

In Part II of its Opening Brief, Mountain argues that Dr. Wilson's approach is flawed, again insisting that he represented that Carlyle was earning a 16% pre-tax return on its $250 million of equity in Park Water Co. Mountain Opening Brief, page 11. The $250 million figure includes both the equity that financed Park Water's three water utilities and the massive acquisition adjustment that Liberty/Algonquin opted to pay Carlyle.

When Mountain offered its Exhibit MWC-2 at hearing, MCC was provided access to Mountain's budgeted rate base figure for 2016 of $39,888,710. With that rate base, and assuming the last approved Carlyle equity proportion of 56%, the pretax equity cost savings available when the low cost acquisition debt is substituted could be calculated as $2.69 million.[2] . Dr. Wilson previously described this approach as a means of sharing the savings and had based that calculation on an earlier figure for rate base. Exhibit MWC-1, pages 26-27.

The problem the Commission faces in attempting to eliminate the full acquisition premium is that the premium is very large relative to Mountain's size, even after adjusting down to the portion attributable to Mountain. Future regulatory proceedings that would include Mountain's parents might offer opportunities to more fully capture the premium for the benefit of ratepayers.

Mountain argues that Dr. Wilson relied on a cost of debt for acquisition purposes that Algonquin had reported in a press release. Mountain Opening Brief, page 13. In fact, the figure was reported to the SEC in March of 2016 when APUC stated that it had used $160 million of 4.13% debt to complete the transaction. Exhibit MCC-1, p. 18.

Mountain continues to argue its obtuse calculations from Exhibit MWC-5 that serve only to mix figures from the acquisition with test period and current period numbers. These contentions were fully explored in Dr. Wilson's rebuttal and Mountain's cross.

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[2] The rate base of $39,888,710 is funded by 56% equity. The calculation is ($39.885 M x .56 x (.16.7-.0413) = $2.69 M. This calculation obviously uses Liberty's debt cost as reported to the SEC as opposed to the "secret" figure it now purports is financing the acquisition. The lower debt cost would produce a correspondingly larger rate reduction.

F. Liberty Should Be Required To Disclose The Financing Costs For Mountain Water.

Mountain continues to contend its financing terms should be treated as trade secret on the basis of the unsupported contention of Mr. Killeen that Liberty's access to capital will be impaired if the Commission declines to defer to Liberty's unilateral claim of confidentiality. There is no reason to accept this self-validating statement. The facts underlying public utility rates should, to the extent consistent with law, be made public. Only legitimate trade secrets and other information that is confidential by reason of law should be protected. Liberty should be required to disclose this information to the Montana Commission and to its Montana customers.

G. Conclusion

This Commission is obligated to deny Mountain and its corporate parents the ability to recover an acquisition premium in rates in the "done deal" manner which is now before the Commission in this case. Dr. Wilson has demonstrated the financial impact of the acquisition savings and of replacement of Mountain's equity with low cost debt. Customers are entitled to a rate reduction by reason of that change. Liberty/APUC should be required to abide by their claim that they will not seek recovery of an acquisition premium and Mountain Water customers should be held harmless from this transaction.

Respectfully submitted this 23rd day of May, 2016.

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