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 RESPONSE TO MOUNTAIN WATER COMPANY'S POST-HEARING BRIEF

Mountain Water Company's (Mountain Water) post hearing brief attempts to establish a presumption in favor of its current rates based on the faulty logic that rates were deemed just and reasonable under Carlyle Infrastructure Partners, LP ("Carlyle") and therefore are just and reasonable under Liberty Utility Co. and Algonquin Power and Utilities Co.'s ("Liberty/Algonquin"). Mountain Water then goes on to argue that the Public Service Commission ("PSC") cannot reduce rates based on the change in cost of capital. False. The PSC has broad rate-making authority and can use it as necessary to protect consumers, even if it has not used the exact same approach prior the unprecedented circumstances now before it. Finally, Mountain Water attempts to dissuade the PSC from taking action because the analysis is simply too complicated, and might result in insufficient profits. However, the critical cost-of-capital figures (16% under Carlyle and 2% under Liberty/Algonquin) are undisputed, making the analysis very easy. Even if the PSC is unwilling to reduce rates by the full $6.127 million excess under Liberty/Algonquin, it should provide meaningful relief to consumers by eliminating Mountain Water's $3,250,470 in equity returns until Liberty/Algonquin completes the application process and the PSC can fairly determine its fitness to own the utility.

I. Mountain Water's Rates are Not Entitled to a Presumption of Lawfulness or Protected by a Burden of Proof.

Mountain Water relies on a flawed premise in an attempt to create a presumption in favor of it excessive rates or to insulate itself with a burden of proof. That premise is that its rates are presumptively reasonable under Liberty/Algonquin because they were allowed under Carlyle. The flaw is this logic is obvious. Rates were established based on all necessary and relevant factors. A necessary and relevant factor has substantially changed. So too must rates, if they are to remain just and reasonable. Mountain Water's fundamental argument to the contrary—that rates <u>are</u> reasonable because they <u>used to be</u> reasonable—cannot justify continued overpayments by ratepayers.

From this mistaken premise, Mountain Water argues that some other party (apparently, according to Mountain Water, an intervenor) must have the burden of disproving this supposed *prima facie* "evidence" that its rates are lawful. In addition to relying on a faulty logic, the argument misunderstands the law and the facts.

The PSC is exercising its authority under Mont. Code Ann. § 69-3-324 to investigate Mountain Water's rates and make whatever changes may be just and reasonable. When the PSC issues its Order, *then* and *only then,* any party contending the Order is unreasonable will have the burden of proof on that issue. Mont. Code Ann. § 69-3-402(4). In the meantime, Mountain Water cannot deter a change to its rates by attempting to impose a burden of proof on some other party base on some non-existent *prima facie* evidence.

Mountain Water's citations to § 69-3-110(2) and *Qwest Corp. v. Mont. Dep't of Pub. Serv. Regulation*, 340 Mont. 309, 317 (2007) misstate the law. These authorities do not, as Mountain Water claims, bestow its outdated rates with a presumption of lawfulness that the PSC must overcome. Instead, Mont. Code Ann. § 69-3-110(2) provides that rates fixed by the commission are prima facie lawful "**until changed or modified by the commission.**" (emphasis added.) That is, the rates set by the PSC are presumed lawful for purposes of enforcement. This statute empowers collection of fees authorized by the PSC; it does not provide the utility a head start in future rate analysis. The statute specifically provides for changes and modifications by the PSC, like those contemplated here.

Nor does *Qwest* support Mountain Water's attempt to shift the burden. *Qwest* involved a challenge in the reviewing court to a PSC Order, an entirely different procedural posture. Moreover, in *Qwest*, the Montana Supreme Court simply noted that the *District Court* had determined that the burden of proof was on the party challenging rates. *Id.* at ¶ 35. The Montana Supreme Court promptly reversed the District Court's Order. *Id.* at ¶ 40.

II. The Evidence Before this Commission Proves that Rates are not Just and Reasonable.

Mountain Water asserts that "[n]o party in this matter has presented evidence that Mountain Water's rates are not just and reasonable under the current approved capital structure and cost of capital." (Mountain Water's Post Hearing Brief at p. 6.) To the contrary, Dr. Wilson presented undisputed evidence that rates are not just and reasonable. As set forth in the City's opening post-hearing brief, Dr. Wilson presented evidence that the cost of capital was around 16 percent under Carlyle. Mountain Water expert Thomas Bourassa admitted that this was an accurate calculation and is embedded in the rates that ratepayers pay today. Dr. Wilson introduced evidence that Liberty's rate is 4.13 percent or lower. And indeed, Liberty's Director of Regulatory Operations William Killeen admitted that Liberty's rate is "probably around 2 percent, possibly even lower than that." (*See* Transc. 150:5-12 (May 3, 2016).).

Mountain Water contends that none of these undisputed facts matter because acquisition costs were paid by Liberty, not Mountain Water. Liberty/Algonquin's endless attempts to evade responsibility by manipulating the corporate form should not be indulged, and cannot be under Montana case law. The Montana Supreme Court has held that the PSC can and must consider the profits of the parent company in its determination of just and reasonable rates. *Mountain States Telephone and Telegraph Co., v. Dep't of Pub. Serv. Reg.*, 191 Mont. 331 (1981).

The new ownership conglomerate would have the PSC believe that Mountain Water is too far down the corporate ladder to benefit from Liberty's actions, Algonquin is too far up to scrutinize, and Liberty itself can simply "retire[] the Term Loan Agreement on its books through an infusion of equity" or use some other corporate shenanigan to evade the PSC. The reality is that Mountain Water's profits are Liberty's profits and ultimately are Algonquin's profits.

Alternatively, Mountain Water further argues that the terms of its purchase should not affect its allowed return on equity. Mountain Water attempts to illustrate its point with the example: an individual who receives a share of stock as a gift is entitled to the same return as if he or she had paid market value for the share. The critical distinction, of course, is that Mountain Water is a *regulated utility*. As such, it enjoys enormous business benefits: monopoly control over an essential service. But unlike private individuals who are not allowed to monopolize basic necessities of life, regulated utilities have some limitations. For one, a regulated utility does not get to reap the windfall of lower capital costs. Instead, it gets to continue making a just and reasonable return, while the benefit of the lower cost goes to its captive consumers. That is the covenant that Liberty/Algonquin bought into, and that the PSC must enforce.

III. The Commission is not Prohibited from Modifying Rates Based on a Major Decrease in Cost of Capital.

Mountain Water argues that the PSC cannot alter its rates because to do so would be "single issue ratemaking," contrary to PSC precedent. Alternatively, citing 1943 federal case law, Mountain Water argues that rates can only be established based on comparisons to other enterprises with corresponding risks. Mountain Water overstates the precedents on which it relies, and is conspicuously silent as to the unusual circumstances of this case.

The PSC is bestowed with the authority "to investigate **<u>any</u>** of the rates, tolls, charges, rule, practices and services" and to "make by order such changes as may be just and reasonable." Mont. Code Ann. § 69-3-324 (emphasis added.) "In determining what is just and reasonable, the PSC is not restricted to any single formula, if the method followed and the order entered 'when applied to the facts and viewed as a whole do not produce an unjust or arbitrary result.'" *Mont.-Dakota Utils. Co. v. Mont. Dep't of Pub. Serv.*, 231 Mont. 118, 121, 752 P.2d 155, 157 (1988) (quoting *Montana-Dakota Utilities Co. v. Bollinger* 632 P.2d 1086, 1091 (Mont. 1981).

The PSC Order cited by Mountain Water, Order 7375a, D2014.6.53, involved the PSC's decision to discontinue a "lost revenue adjustment mechanism" ("LRAM") which allowed regular, ongoing rate adjustments between cases for the benefit of the utility. The PSC's decision to discontinue those regular rate adjustments was based in part on the principle that rates generally should be adjusted comprehensively. *Id.* at ¶ 36. The Order did *not* hold that rates could *never* be adjusted except as part of a comprehensive rate case. If that were so, the PSC would not previously have permitted the LRAM, nor would the PSC have bothered to provide at least for other reasons to discontinue the LRAM. *Id.* at ¶¶ 37-40. Order 7375a simply recognizes that comprehensive rate analysis is the preferable means of modifying rates under general conditions.

Because the circumstances created by Liberty/Algonquin's actions are unique, an adjustment to rates based on the changes to the cost of capital will not threaten the general principle that rates should typically be adjusted as part of a comprehensive rate case. Mountain Water's contention that "[t]here is simply no valid reason for the Commission to depart from its long-observed standard of setting rates through thorough and complete ratemaking proceedings," is plainly wrong. Liberty's unauthorized purchase, which deprived the PSC of the opportunity to properly vet the new owners and resulted in excessive rates for Missoula consumers, is a valid and compelling reason to immediately adjust rates.

IV. The PSC Should Reduce Mountain Water's Return on Equity to Reflect the Changed Cost of Capital.

Mountain Water's proceeds with a dizzying series of calculations intended to convince the PSC that it is hardly making any profit.[1] At the same time Mountain Water is pleading poverty to the PSC, its owner is striking a very different tone with investors. Algonquin Power and Utilities Co. CEO Ian Robertson recently told investors that Algonquin is expecting **8 to 10 percent rate-based growth** from Mountain Water and the other Park Water utilities. Algonquin Power & Utilities Q1 2016 Results – Earnings Call Transcript, p. 6, attached as **Exhibit 1.** Between Mountain Water's protestations to the PSC and Algonquin's assurances to investors, history suggests the latter is more reliable.

Mountain Water's argument generally appears to be an effort to muddy the waters sufficiently to dissuade the PSC from taking any immediate action. The PSC must not reward the continued obfuscation by simply throwing up its hands and letting Mountain Water/Liberty/Algonquin continue to profit from their impudence. Instead, the PSC should adopt Dr. John Wilson's recommendation of eliminating Mountain Water's equity return until the transfer docket is re-opened so the PSC can complete its review of Liberty/Algonquin. This approach achieves the immediate and most

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[1] Mountain Water argues at length that Dr. Wilson was incorrect in calculating the new cost of capital is 4.13 percent. This protected argument is odd, since the 4.13 percent figure became moot once Liberty's William Killeen acknowledge that the actual interest rate for the financing of Mountain Water is 2 percent or less. Dr. Wilson's calculations were only incorrect because they *understated* how far the cost of capital has fallen.

important goal; restoring Missoula's water rates to something in the realm of "reasonable and just." It does so in a fair and logical way that corresponds to the cause of the excessive rates (i.e. lower cost of capital.) The approach has the additional, collateral benefits of encouraging Liberty to complete the mandatory process of obtaining PSC approval of the purchase, and of discouraging future disregard of the PSC by other corporations. Finally, this approach has the advantage of certainty because Mountain Water itself has provided an exact number. Its post-hearing brief acknowledges that Mountain Water's pre-tax return on the equity funded portion of its rate base is $3,250,470.

As Dr. Wilson testified to this Commission, eliminating the equity component from Mountain Water's rate of return would still provide Mountain Water a return of 3.68 percent. Because it would still realize a profit under this scenario—albeit temporarily less than it would prefer—Mountain Water's arguments about confiscatory rates and insufficient operating income are moot. Moreover, Mountain Water's own corporate parents would hold the keys to restoring the full return on equity.

Dr. Wilson calculated that Mountain Water/Liberty/Algonquin is actually enjoying about $6.127 million in increased profits (and that was before he knew their cost of capital is only 2 percent or less). Missoula ratepayers should receive the entire benefit of the $6.127 million (or more) in savings. But, by eliminating $3,250,470 from the annual returns the PSC can at least provide consumers with a meaningful share of the savings prior to full recalibration in a future rate case. Mountain Water and its new owners would have no valid grounds for protest, since they will still enjoy a handsome *increase* in annual profits relative to the Carlyle era.

V. The PSC Should Grant the Motion to Unseal the Loan Documents Associated with Liberty's Purchase of Mountain Water.

Mountain Water argues that the PSC should prohibit public access to documentation of its cost of capital because disclosure of that information would compromise Liberty's "ability to maintain the confidentiality of the Financial Documents." The audacity of Mountain Water asking the PSC to stand up for Liberty's trustworthiness boggles the mind, and merits a moment of reflection.

From a legal perspective, though, the analysis is a simple matter of balancing interests. On one side of the scale is Montanans' right of to access and review the documents, guaranteed by the Montana Constitution. On the other side of the scale is the potential that the lawful disclosure of the specific terms associated with Liberty's two percent interest rates might discourage some future lender from lending to a foreign corporation that has disavowed any obligation to Montana authorities.

The scales come crashing down in favor of disclosure.

Dated this 23rd day of May 2016.

for Scott Stearns

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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 23rd day of May 2016:

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EXHIBIT “1”

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Algonquin Power & Utilities' (AQUNF) CEO Ian Robertson on Q1 2016 Results - Earnings Call Transcript

May 13, 2016 2:33 PM ET
by: SA Transcripts

Algonquin Power & Utilities Corp (OTCPK:AQUNF) Q1 2016 Earnings Conference Call May 13, 2016 10:00 AM ET

Executives

Christopher Jarratt – Vice Chair

Ian Robertson – Chief Executive Officer

David Bronicheski – Chief Financial Officer

Analysts

Paul Lechem – CIBC

Rupert Merer – National Bank

Sean Steuart – TD Securities

Jeremy Rosenfield – Industrial Alliance Securities

Eric Tang – BMO

Operator

Thank you for standing by. This is the conference operator. Welcome to the Algonquin Power & Utilities Corp. 2016 First Quarter Results Conference Call. As a reminder, all participants are in listen-only mode, and the conference is being recorded. [Operator Instructions]

I would now like to turn the conference over to Christopher Jarratt, Vice Chair of Algonquin Power & Utilities Corp. Please go ahead, Mr. Jarratt.

Christopher Jarratt

Thank you. Good morning, everyone, and thanks for joining us for our 2016 first quarter conference call. My name is Chris Jarratt, and I am the Vice Chair of Algonquin Power & Utilities Corp., and joining me on the call today are Ian Robertson, our Chief Executive Officer, and David Bronicheski, our Chief Financial Officer.

Today we are happy to be hosting the call from the Empire District Electric offices, which are located in Joplin, Missouri. Also as usual for this call, we have a supplemental webcast presentation that you can access from our webpage. To access this presentation, please go to our home page, algonquinpowerandutilities.com, and you will find instructions on how to gain access.

This presentation, along with additional information on our Q1 2016 results, is also available for download on our website. As usual, on this call, we will be providing information that relates to future events and expected financial positions which should be considered forward-looking. And we will provide additional details at the end of this call. You can also review our full disclosure on forward-looking information and non-GAAP financial measures on our website. We will be reading the full disclosure at the end of the call.

This morning, Ian will discuss the first quarter growth highlights. David will follow with financial highlights, and then Ian will conclude with our 2016 outlook. We will open the lines for questions at the end of the earnings presentation, and I would ask you that you restrict your questions to two and then re-queue if you have additional.

Now, I would like to turn things over to Ian to present some of our first quarter growth highlights.

Ian Robertson

Thanks, Chris. And good morning, everyone. Thanks for taking the time to dial in this morning. As Chris mentioned, I would like to start by thanking the Empire team for their hospitality for allowing us to host the call from their offices here in lovely downtown Joplin.

I will say that the strong culture of connections which are apparent between Empire and Algonquin are certainly providing me comfort and confidence with respect to the ease of integration - the coming integration of our two businesses.

So I'll take a couple of minutes to walk you through some of the highlights, certainly from my perspective, before I turn things over to David to detail financial results. And I there is three things that I would like to highlight this morning.

First, I think we're pleased with the strong start to the year, solid financial performance, $148 million in adjusted EBITDA. It represents close to 30% increase over the same quarter last year. Pleased with the material gains and adjusted funds from operation and adjusted share earnings of close to 20% and 24%, respectively.

But secondly, and perhaps I think more importantly, it was another quarter in which the diversification and resilience of our portfolio showed its worth. With one of the warmest winters on record behind us that negatively affected some of our financial results and our electricity and natural gas sales.

I think we're pleased to see the generation business group was able to carry the load with strong performance from good wind and solar resource conditions. And I think it's this reduced performance volatility from the portfolio, it's providing a solid source of shareholder value.

And lastly, the third highlight is I think the growth aspect of the Algonquin story is remaining clearly visible and intact. The financial results include the gains and earnings from new assets within both the generation and distribution business groups.

Together with support of a number of recently completed rate cases, completing the Park Water acquisition early in the quarter allowed the 75,000 new customers to contribute to the results of our distribution businesses in California and Montana. We look forward to future gains from initiatives on both sides, or actually on the generation distribution and the transmission groups coming forward.

Within the generation group, we continue to push forward on our projects under construction: our 10 megawatt Bakersfield II Solar project in California is nearing completion.

200 megawatts of wind in Odell in Minnesota is targeting completion in July. And lastly, on the 2016 to do list, 150 megawatts worth of wind up in the thumb of Michigan is advancing towards commercial operation at the end of this year.

Shifting to the transmission front, we are obviously disappointed that Kinder Morgan's own internal struggles impacted their Northeast energy direct pipeline and therefore an investment opportunity for us.

Obviously pleased that we structured the opportunity with the optionality that we built into it. But we are also comfortable that other transmission opportunities are presenting themselves. We are continuing to advance our California intrastate electricity transmission project. Phase 1 of that investment is scheduled for completion this year.

And it might also be noted that Empire brings close to $300 million Canadian in existing electro transmission assets to the business and presents more than $30 million a year in near-term investment opportunities.

And then lastly, with respect to our distribution business and the Empire acquisition, we're pleased to report that in March of this year, we submitted our FERC application, as well as applications for transfer approval in Oklahoma, Kansas, Missouri, and Arkansas, and the work is already bearing fruit.

So the FERC approval was granted on May 6 of this year, and we're also pleased that the first of the four state commissions has granted their approval with Oklahoma Corporation Commission signing an order as recently as yesterday.

June 16 is the date for the Empire special meeting of shareholders to hold a vote on the transaction, and we are cautiously optimistic that the reception will be extremely positive.

While it's early in the process, and we are making progress, we don't underestimate the work that needs to be done and we're going to continue to work with the Empire team and the regulatory agencies to bring the transaction to conclusion.

But as I sort of started the conversation about the corporate cultural alignment, it's really showing as we work our way through the regulatory approval processes. I think there is a very close connection between our respective organizations.

And so lastly, with the strength of solid financial performance through last year and a start to this year that was equally strong. We're pleased to announce yesterday that the Board of Directors approved a 10% increase to our dividend, and it's now US $0.4235 per common share, and I think that 10% increase is consistent with our dividend growth target, which we've communicated to the capital markets.

And I will highlight that this is the sixth year, consecutive year of double-digit annual growth in our dividends from a percentage perspective. And then, as we look forward to the pipeline of growth opportunities in front of us, we are confident that those increases certainly over the next little while – we're comfortable that they are going be supportive of our growth targets.

So with that, David, why don't you take it over from a financial results perspective.

David Bronicheski

Thanks Ian, and good morning, everybody. We're pleased to be reporting strong financial results for the first quarter here in 2016. And when you get off to a good start, that likely means you are going to have a very good year.

As Ian mentioned, the diversification of our portfolio and success of our growth program is clearly evident in our results. Even though we had warmer weather than average in some of our utilities systems in the US, our revenues, net of the commodity pass-though cost, were still up $37 million in the quarter compared to the first quarter of last year, an increase of 19%.

As we look at our adjusted EBITDA in the first quarter, it totaled $148 million, a 29% increase over the amount reported in the same quarter a year ago. The increase in EBITDA over the previous year was due to strong wind and hydrology, which contributed $8.8 million of additional EBITDA, which more than offset the effects of the warmer winter at our distribution utilities, which had lower EBITDA by approximately $4.6 million, compared to Q1 of 2015.

Our growth program saw two new generating stations come online: Bakersfield and Morse. As well, we had our newest utility, Park Water and collectively they all contributed about $9.5 million of new EBITDA.

Finally, we continue to demonstrate effective management of our investment and rate base and our regulatory processes. We had positive rate case settlements contributing more than $3 million of new EBITDA in the quarter. All in all, I think we are quite pleased with the quarter and say it was quite successful.

For the three months ended March 31, adjusted EPS was $0.21, up 24% from the previous year. Our adjusted FFO, $121.8 million, and that is up 21% compared to Q1 a year ago. And both of those metrics really underscore the Board's decision to increase the dividend this quarter by 10%.

Now turning briefly to our financing initiatives, we were pleased that we have been able to satisfy all of our equity capital needs for our acquisition of Empire. Our convertible debenture offering was well received in the capital markets. It was oversubscribed and had strong institutional support. As a result, the over-allotment option was exercised by our underwriters, bringing the total equity capital to $1.15 billion.

With respect to our debt requirements, we will be meeting with key fixed income investors over the next several months, and we expect to be active in the US private placement market come the fall to complete our financing for Empire.

So with that, I will turn things back over to Ian.

Ian Robertson

Thanks, David. As we move through the balance of the year, I think we feel that there's lots to look forward to. We remain committed to our growth plan, both this year and next. I think we are well-positioned to deliver on our 2016 capital initiatives. Construction's proceeding on the Odell and Deerfield projects; rate cases are well underway in California and Arizona.

We are obviously going to continue to work with our partners here at Empire to facilitate the approval of the acquisition by both their shareholders and the regulatory agencies, and I think we're off to a great start at that.

Work is proceeding with respect to the integration of the businesses, and frankly, the objective is having one plus one equaling more than two in the context of Empire and Algonquin and we feel strongly that that opportunity continues.

But lastly, there is obviously no rest. The growth plan takes continual work. We're continuing to focus on growing the pipeline. We think there are strong tailwinds to the whole renewable energy sector here in North America, and we are working hard to add more opportunities to the pipeline.

We think that both Canada and the US have lots to offer in terms of continued growth for this organization going forward, and so we are comfortable with certainly where we sit today, and obviously look forward to bringing more opportunities to you as they develop.

So, Operator, with that we will open up the lines for any questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] And our first question will come from Paul Lechem of CIBC.

Paul Lechem

Thanks, good morning.

Ian Robertson

Good morning, Paul.

Paul Lechem

Morning, just on the Northeast energy direct project, do you have any financial exposure to the cancellation? Did you invest any amounts that will be unrecoverable at this point?

Ian Robertson

Well, we certainly had an investment of a few million dollars. I think that is highlighted in our MD&A. We have no financial exposure, if you want to think of it, that would sit outside of that, no contingent liabilities or liabilities related to the cancellation, other than potentially the forfeiture of the investment we've made to date.

I will highlight interestingly, though, that just because Kinder Morgan wasn't able to proceed with the project, that doesn't actually solve the problem of gas constraints in the Northeast.

So I think we are thrilled that there are - there are going to be continued opportunities for us to participate in that solution, whether it's expansion of existing pipelines, perhaps building some new infrastructure ourselves, or frankly something a little bit off the normal fairway in terms of expanding our LNG project to help deal with the constraints. I think our enthusiasm for the Northeast and participating in that solution in creating investment opportunities isn't dampened at all, Paul.

Paul Lechem

Yes, I was going to ask about, are you in discussions at all with Spectra's Access Northeast project, or is this something that wouldn't fit in with your footprint as well?

Ian Robertson

Well, I think obviously Spectra has got a number of expansions underway, but they are not the only guys who could look at an opportunity. You think of Iroquois TCPL and PNGTS as a potential path to bring shale gas in to the Northeast. Obviously, could come from the South, as you mentioned, through to the Spectra pipeline.

I think, and as I said I think interestingly that LNG could be an interesting component of the solution to the Northeast constraints. You will recall at our investor day, I think we said that pipelines in LNG both can participate in the solution. We are not sure exactly who is the winner is going to be, but we want to back both horses, so that whoever wins, we've got a ride in that race.

And so, I think right now, Paul, we are agnostic as to what the right solution is, but the demand is still there. You know we ourselves have continued demand to supply the needs of our customers and the other LDCs that were left in the lurch, if you want to think of it that way, from Kinder's decision also continue to have needs. So I think there is great opportunity.

Paul Lechem

Okay, just another question, if I may. On the hydro facilities, the global adjustment revenues you discussed in the MD&A. Can you give a bit more color around how much that was, and what that will be going forward. What the benefit will be going forward. Thanks.

David Bronicheski

We are expecting that annually, going forward, it is going to be an extra $1.5 million to $2 million per year of revenue, and that is starting to be reflected, obviously, in this quarter's results. There will be a retroactive component under GAAP.

We are not allowed to actually recognize that retroactive amount until the cash actually hits our bank account. We are expecting that to happen either late in Q2 or early Q3.

Paul Lechem

Great. Thanks very much, guys.

Ian Robertson

Thanks, Paul.

Operator

Our next question comes from Rupert Merer of National Bank.

Rupert Merer

Good morning, everyone.

Ian Robertson

Hey, Rupert.

Rupert Merer

Outside of the transmission opportunities you discussed, what is your current view on the rate-based growth opportunities in your existing distribution business, and maybe with Empire coming in as well?

Ian Robertson

Well, I mean, I guess one of the ways to look at it, we sort of saw Empire as bringing themselves forward, 4% to 5% growth opportunities within their business, and they are pretty much 100% regulated earnings themselves. And that we are continuing to grow the rest of our business.

It's a couple hundred million dollars worth of CapEx going into our businesses, including Park Water. As you know, part of the thesis for Park Water was the latent capital investment opportunity, and that's probably closer to 8% to 10%, in terms of rate-based growth.

So combine the two together, and you are probably talking somewhere between 5% and 10% growth just on the regulated side. As you obviously know, we enjoyed the benefit of the growthiness of the IPP business, which can supplement that. So it's probably tending, it's about 5% and trending towards double digits, Rupert.

Rupert Merer

So with the IPP business, you talked a little in your comments about potential for growth there. Do you see that growing from 25% of the business to something bigger again? How do you view the future opportunities, thinking maybe a little more long-term?

Ian Robertson

Sure. I think our position, as we articulated it, is that this 10 seconds, the pendulum for us upon the closing of Empire will have swung, as you accurately point out, to over 70% from a regulated perspective. But I don't think people should see that as somehow as a strategic set point change for the organization.

And as I've often articulated, one of the huge benefits of bringing Empire into the Algonquin portfolio is that, we will call it the headroom. It's occasioned by that in terms of being able to grow the IPP business.

We obviously love the opportunity where our entrepreneurial spirit can be brought to bear to surface opportunities in the IPP business. So you should definitely expect us to be sort of continually aggressive on finding IPP opportunities. As I mentioned earlier, I think the tailwinds for the sector are quite strong, with the extension of the PTCs and the ITCs.

I think the continued environmental pressures, and maybe most importantly, the continued economic trends that make wind, certainly today, and solar, hopefully tomorrow, just the economic choice for providing new energy.

So, Rupert, the foot is not coming off the gas pedal at all on the IPP side of the business, and we're certainly, you would expect to see that pendulum quite happily swing back toward the 50/50, unless of course we can keep growing the utility business and keep it there. But no way are we taking our foot off the gas on the IPP side.

Rupert Merer

Just a quick follow-up, then, if you were to look at the return opportunities in the market today, sort of your after-tax levered IRRs, how do they compare in the distribution opportunity versus the IPP opportunity?

Ian Robertson

Well, as you well know, when one looks at the return metrics associated with the distribution business, really an ROE or an equity unlevered return, because the benefit of leverage, quite understandably, is for ratepayers, and so consequently we look at it, we look at our investment in that from an equity perspective.

And ROEs, I think we are pleased to be able to say, remain relatively stable. We are not seeing continued erosion in those ROEs. In recent settlements, they have been 9%, 9.5% and even trending toward 10%. So that is obviously good news.

The IPP business is quite different. Obviously, that is where the benefit of leverage is for our account, and so we look at it on an unlevered, after-tax IRR basis, and you know that we are seeing projects, our focus is north of 8%, certainly on the winning side, on an unlevered basis, and if you look at our - the leverage strategies that we use, you can probably think of that as 50/50. So that brings the equity return into the teens.

So it's just a different business proposition, but we certainly think the risk return profiles are equally attractive on both sides. I'm not sure if that is responsive to your question, Rupert.

Rupert Merer

Yes, very much. So, thanks for the color Ian…

Ian Robertson

Yes. Thanks, Rupert.

Operator

And the next question comes from Sean Steuart of TD Securities.

Sean Steuart

Thanks. Good morning, everyone.

Ian Robertson

Hey, Sean.

Sean Steuart

Couple of questions. Maybe I misread it that it looks like Val EO and Great Bay Solar have been reclassified into the development pipeline versus the construction pipeline. Any changes to those projects we should be aware of?

Ian Robertson

No. I think it's probably changes more, as we think of our pipeline and our workload. Both of those projects received their final permits, and so the decision to kind of go ahead with those rests solely with us.

But that we felt, until we were actually digging holes in the ground, maybe it felt a little bit inappropriate to put them in an, quote unquote, in construction category. And so consequently, we wanted to leave them in development.

And the question is, well why aren't you digging holes in the ground if you have all of your permits? Well, two things have happened: one, certainly, we've got lots to do, as you know, 350 megawatts of wind and another 10 megawatts of solar that are actually under construction right now, and so obviously there is lots of work underway.

And the extension - the second thing, what the extension of the ITCs for another five years has given us certainly takes the pressure off something like Great Bay Solar, which prior to the extension last year of the ITC/ PTCs, would have to have come online by December 31 of this year.

I think we said we've got the opportunity to defer this for a few months while we are busy; there's nothing to be gained by loading up the construction group. I think that is just obviously creates risk where it doesn't need to be any, because of the time pressures. And the second thing is - that applies obviously to both Val EO and Great Bay.

The other thing that we are obviously considering is the extension of the ITCs has its own implications, which we're working our way through, from a supply demand dynamic within Maryland and the supply of SRECs. What the heck is that going to do to the SREC market?

I guess it is a good news, bad news story. The good news is that the solar carveout has been increased as a percentage under the legislation governing SRECs, so therefore compliance buyers need to buy more SRECs in terms of a percentage of their delivered energy.

The bad news is the extension of the ITC obviously creates incentive for a continued supply, so it is balancing the increased demand and the increased supply, and to understand where that market is going, because obviously SRECs are an important component of the solar equation as it stands today.

So I think we're just being cautious, Sean. I don't think you should see it that those projects have hit any roadblocks from a permitting or construction perspective. It's just being prudent.

Sean Steuart

Understood. And just following on that, and Rupert's earlier question, with respect to generation growth aspirations, you guys are clearly comfortable with tax equity and with the extension on the PTC/ ITC side.

Given that, and very competitive bidding internationally for renewable procurements, is there any reason we should expect you to look outside the US in the mid-term for generation growth?

Ian Robertson

I mean, I don't know if your use of mid-term was intentional. I think the short-term is no, man, we have lots to do, so that's probably a fair, I'd respond we would not be looking outside of North America in the short term.

Mid-term is a little bit longer. I think we have to watch the evolution of the market, and as I've said in previous earnings calls, understanding what is happening in the international market is not a process that you want to undertake when you need go to the international markets.

So you will hear us, if you follow the scuttlebutt in places like Mexico, the RFP that's underway right there. We are getting ourselves up the learning curve in terms of those marketplaces, so that we can always be making that risk/ return evaluation to see whether introducing country risk, and maybe a different currency risk to our shareholders, is offset by higher returns. But it's not something that is near-term to us, but mid-term, I think I will have to be a little more cagey, Sean, and say not really sure.

Sean Steuart

Good enough. Thanks, Ian.

Ian Robertson

Thanks, Sean.

Operator

And the next question will come from Nelson Ng of RBC capital.

Unidentified Analyst

Hey guys, this is Orhan actually filling in for Nelson, right now. Most of my questions have been asked, but just had a follow-up on the OAFC Global Adjustment payment? You said that there's going to be a retroactive payment in late Q2 or early Q3. Do you have any idea of roughly what it's going to be?

David Bronicheski

For us, rough calculations for us, $8 million to $10 million.

Unidentified Analyst

And then I guess it's dependent on whether or not they will appeal the whole process, right? This is not a guaranteed amount.

Ian Robertson

Well, it is Ian speaking. The appeal has to go to the Supreme Court of Canada, and I'm not sure that this is an issue of public policy in front of the Supreme Court.

Unidentified Analyst

Okay. Fair enough. And then with regards to CapEx timing, I noticed that you spent about $80 million this quarter, and just looking at your budget for the year of $700 million to $925 million, could you provide some color on the timing of that? Were there any delays due to weather, or is everything going as expected, and that amount still holds?

David Bronicheski

Yes, the guidance we have in there still holds. The $700 million to $900 million is obviously inclusive of the Q1 spend, just to be clear on that. Q1 does tend to be a lower quarter for us on the capital.

You can imagine that a number of our distribution utilities in the Northeastern US don't get around to doing a lot of construction in the wintertime. The same thing for our development projects as well. So you will see the CapEx spend accelerate in Q2 and particularly Q3 of this year.

Unidentified Analyst

Okay, fair enough. That will be it for me. Thanks.

David Bronicheski

Thanks.

Operator

And next we have question from Jeremy Rosenfield of Industrial Alliance Securities.

Jeremy Rosenfield

Thanks. Good morning, everyone.

Ian Robertson

Hey, Jeremy.

Jeremy Rosenfield

Just couple of quick question. First, when you look at the power portfolio, Odell I think you have the option to exercise to acquire the remaining 50% after that project hits COD, if I'm not mistaken? Can you talk about what considerations would go into you exercising or choosing not to exercise that?

Ian Robertson

Sure. I mean I think first of all let me say you did get it technically correct, in a relatively short period of time, 30 or 60 days, after the project hits COD, the option to exercise comes up. I think we obviously always structure our opportunities with as much flexibility and optionality that is possible.

I think there's nothing that would lead us to believe right now that as we look at the project and we look at its completion, that owning the other 50% wouldn't be is attractive as owning that first 50%, but I don't think we are - we are not pre-committed, if you will, to exercising the option.

But I think from your perspective, if you're thinking of modeling that business, I mean we are not unhappy with the first 50%, and so therefore we probably wouldn't be unhappy with the second 50 might be the way I would look at it, Jeremy.

Jeremy Rosenfield

Okay. Good, fair enough. Then a question I think I've probably asked on previous calls, and I'm sorry if I'm bringing it up again, but as you look out to potentially post-closing, still early, but post-closing an acquisition of Empire, you look at the overall portfolio, and there some assets that are getting to be relatively small.

Are you thinking sort of ahead as to if some of those assets may no longer fit within the overall business because they are now relatively small and kind of marginal? Have you thought about potentially monetizing some of that?

Ian Robertson

I think one always looks at the portfolio composition in the context of who you are at the time and whether a 1 megawatt hydro plant, that's kind of which were making reference to - still continues to fit in a portfolio of a $10 billion business. We have to ask ourselves those questions.

Though I will say that our grouping, if you will of small hydro assets, still feels to be rational and reasonable. As you think about them geographically, they support each other from an efficiency and economies of scale perspective, so absent sort of making the decision to divest ourselves, if you will, of the entire small hydro portfolio, I'm not sure there is a thesis for getting rid of any one of the individual assets.

And so I don't think that the growth that is going to be evidenced by bringing Empire into the mix somehow fundamentally changes our look at our current portfolio. We think each one of those assets continues to contribute appropriately to the business.

We certainly, as I said, look at this quarter's results and maybe just going back to my opening comments about the diversification and the resilience of the portfolio. Man, it was the hydro guys who carried the load this quarter, and it's hard not to enjoy the orthogonality of risk that's associated with those different businesses.

So I guess I will respond to you the same way as last time, Jeremy, is we are comfortable with the portfolio composition, but it is something that we always keep our eye on. But nothing at this stage.

Jeremy Rosenfield

Okay, perfect. I will leave it there for the moment and get back in queue.

Ian Robertson

Thanks, Jeremy.

Operator

[Operator Instructions] And our next question will come from Eric Tang of BMO.

Eric Tang

Hi, guys. This is Eric filling in for Ben. Most of my questions have been answered. Just a quick one. Given the volume downside we saw in Q1, are there any plans to decouple some of your utilities in the Northeast?

Ian Robertson

Well, let me start by saying, I guess from our perspective, we have to look at our results across the portfolio. And so yes, on an individual asset basis, some are up and some are down, and so we like to think that the quarter was nice and solid, when you look at it across the portfolio.

Obviously, I think with respect specifically to your question on the Northeast and the impact of the incredibly warm winter that we suffered, certainly New Hampshire as a state doesn't have particularly progressive decoupling provisions, that's just a fact. There are initiatives underway for that to happen.

We are obviously cheering from the sidelines for those initiatives. They are not initiatives that we can unilaterally implement, but we can certainly try to provide testimony and guidance back to the commission as to the benefit, and to be frank, it's not just benefit to us, it's benefit to the ratepayers as well from our perspective.

I think everybody likes predictability and stability, and those are some of the best, from our perspective, I think the right way to go. So we are pursuing them. We are supportive of them. But unfortunately the reality is they just not in place, certainly in New Hampshire.

But as I said earlier to Jeremy's call, isn't it great that we have a portfolio where in this case the generation group stepped up, if you want to think of it that way, with stronger-than-expected or stronger-than-average results to make up for some of those shortfalls. And it's interesting, I'm not a climatologist, but one wonders, of course, whether the wetter weather and the windier weather are somehow influenced by the same weather patterns that brought us the warmer weather in the Northeast.

So maybe this is a natural hedge that exists. But the fact of the matter is the portfolio did better as a result of having that diversification. So I'm not sure if that, Eric, is where you wanted to go with the question?

Eric Tang

That answers it fair enough. Just going back to the Empire acquisition. What is your longer-term accretion, I guess target budgeted for beyond three years? Do you have a target in mind at the moment?

Ian Robertson

From an accretion point of view, three years out, obviously we are hoping to bring more to the investment opportunity, that was clearly in the portfolio of CapEx that was reflected in our acquisition numbers.

Those were numbers that we frankly cribbed from the existing Empire management team. This gets back to the comment earlier where our real objective is to make sure that one plus one equals more than two in terms of being able to find growth opportunities.

We've talked about them in the past, this idea of greening the Empire portfolio. The idea of bringing more natural gas and renewables to the Empire mix. Those are all part of the longer-term thesis associated with this opportunity.

And that strategic planning is number one on the agenda as we integrate these businesses and we look out beyond just the near three-year term that the CapEx model within Empire has been currently feathered into our results.

Eric Tang

Okay, thanks. Fair enough. That's all the questions I have.

Ian Robertson

Thanks, Eric.

Operator

And next we have a follow-up question from Sean Steuart of TD Securities.

Sean Steuart

Thanks. Just one follow-up, guys. The LNG potential in Massachusetts, I think when you guys initially talked about it, you were anticipating some regulatory hurdles being met early this year. Any update you can give us on that project?

Ian Robertson

Yes, I would say the regulatory hurdles, there are really two things that are being done from a regulatory perspective: is the national grids approval of their precedent agreement - their agreement to be an off taker for that is in front of the Mass DPU. And right now their approval is expected within this quarter, maybe next quarter in terms of that approval.

The other hurdle, obviously that we have in front of us, is our own FERC application. We obviously want to make sure that the National Grid as a customer is solid before we go to the expense of filing our FERC approval.

I think getting revenue certainty, if you want to think of it that way, for National Grid is something you are going to see in the next quarter or so. And perhaps to add my own follow-on to that answer, as we think about the implications of the Kinder Morgan decision regarding the Northeast energy direct, I mentioned that LNG can certainly potentially play a role in dealing with those supply constraints in the Northeast.

And so consequently ourselves, we may be looking at expanding that project substantially to meet some of those needs, not just for National Grid but for Energy North and some of the other utilities in the area.

So I don't think that the ink is dry, if you will, Sean, on the conceptualization of that project, and maybe the Northeast Energy direct troubles may translate into Northeast Energy Center, which is what we call our LNG facilities, to its benefit.

Sean Steuart

Okay. Thanks for the detail.

Ian Robertson

Thanks.

Operator

And we have another follow-up question and that comes from Jeremy Rosenfield of Industrial Alliance Securities.

Ian Robertson

Jeremy, we are going to have to charge you for this one, but go ahead.

Jeremy Rosenfield

Okay, as long as it is not too much. Just on the debt financing conditions and the strategy for potentially locking in some rates on the debt financing that would be associated with the Empire acquisition, are you looking at potentially doing some of that sooner, or do you want to wait until you get closer to the closing date?

David Bronicheski

Just generally when it comes to hedging strategies, we're always somewhat reluctant, I will say, to get ahead of ourselves. Clearly, I think we want to get past the Empire shareholder vote.

We are confident it will be successful, but we don't want to prejudge anything, and so once we do get through that, I think that will be a time when we will do a reassessment of the hedging strategy both from an interest rate perspective and a currency perspective, but at this point in time we haven't locked anything down.

Jeremy Rosenfield

Okay. And then just maybe a final question, on Amherst Island, still in the waiting process here, kind of frustrating overall. Do you have any considerations, when you take away how long it has taken for Amherst Island, when you think about doing more projects in Ontario, with the LRP II that was just recently unveiled, how does that factor into your thinking, I guess, going forward.

Ian Robertson

Well, I think your use of the word frustrating was probably pretty appropriate. Let me just comment first about kind of where Amherst actually stands right now, is that the ERT is coming to a conclusion.

We are hoping that process wraps up within the next 30 days. I think final arguments are expected to be lodged within, I will call it next couple, three weeks, and so that process will come to an end.

But then when you step, and so we're cautiously optimistic that the ERT, which is really a review of the Ministry of Environments work on the permitting process, will be proven to have been appropriate. But then you step back, and you ask yourself the question, does the permitting paradigm in Ontario, how does it look at compared to other states?

And the short answer is, there is no doubt about it, it is an outlier. There is a complexity, and there is an overhead associated with it, and one needs to think about that in the context of the risk returns associated with Ontario projects. And in some respects, that's a sad statement make because we are obviously proud to be from the province, but at the same time when we look at a project like a Odell, or we look at a project like Great Bay Solar in Maryland, or frankly we look at Chaplin and some of the other projects in some of the other provinces. It really does feel quite different. And so I think if your observation is that Ontario has a level of complexity, I think no truer words were ever spoken.

Jeremy Rosenfield

That being said, you still expect to be participating in LRP II here?

Ian Robertson

I think we've got sites. We've got opportunities. As we mentioned last earnings call, obviously it was disappointing that the effort that has been put into those sites up until now has been, we didn't - we weren't able to capture it in LRP I. It doesn't make the sites any less valuable. They continue to be locked up.

We are working on building the areas that we were perhaps in which they evidenced a shortfall, and that is community involvement and perhaps first nation participation. These are all the things that maybe made the economics of our project, while they were competitive it was perhaps some of the ancillary areas of the evaluation grade which we fell short.

So sure, we want to continue to participate in the process, but you have to take into account the fact that it's a very complex, and arguably expensive, and maybe you can read parenthetically risky jurisdiction. It just is what it is. I guess I am making an observation and not an accusation.

Jeremy Rosenfield

Sure. Good. Thanks, I appreciate it.

Ian Robertson

Thanks for the call.

Operator

[Operator Instructions] Showing no further questions, we will conclude the question-and-answer session. I would like to turn the conference back over to Mr. Robertson for any closing remarks.

Ian Robertson

Thanks, Operator. Thanks, everyone for joining us on the call this morning. Thanks to all the analysts for their questions. And then lastly, a final thanks to the Empire team for their hospitality of allowing us to host the call here from Joplin, and with that I will turn things back over to Chris to give you our disclaimer statement. Chris?

Christopher Jarratt

Certain written or oral statements contained in this call are forward-looking within the meaning of certain securities laws and reflect the views of Algonquin Power & Utilities Corp. with respect to future events based on assumptions relating to, among other things, the performance of the Company's assets and the business, financial, and regulatory climates in which it operates. These forward-looking statements include, among other things, other statements with respect to the expected performance of the Company and its future plans and its dividends to shareholders. Since forward-looking statements relate to future events and conditions by their very nature, they require us to make assumptions and involve inherent risks and uncertainties.

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Operator

The conference is now concluded. You may disconnect your lines at this time. Thank you for participating and have a pleasant day.

Algonquin Power & Utilities (OTCPK:AQUNF): Q1 EPS of $0.21

Revenue of $341.7M (-10.5% Y/Y)

Press Release

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