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THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS

AUG 19 2013

by  
State Corporation Commission  
of Kansas

In the Matter of the Application of Howison Heights, Inc., for Approval of the Commission to Make Certain Changes in Its Rates for Water Service. )

Docket No. 13-HHIW-570-RTS

In the Matter of the Investigation of Howison Heights Inc.'s Ability to Provide Sufficient and Efficient Service. )

Docket No. 13-HHIW-460-GIV

**CURB'S RESPONSE TO COMMISSION QUESTIONS IN JULY 18, 2013 ORDER**

The Citizens' Utility Ratepayer Board (CURB) provides the following answers to questions posed by the Kansas Corporation Commission in its *Order on Motions for Clarification* that was issued on July 18, 2013:

**a. [1] Does K.S.A. 66-136 require Howison's mortgages and other property transfers affecting the water utility assets (e.g., transfers between Howison Heights, Inc. to the Timothy and Melinda Howison Trust or transfers to Timothy or Melinda Howison as individuals) to be approved by the Commission?**

**Answer:** No. CURB agrees with Staff's arguments on this issue.

**[2] What are the legal consequences if the mortgages or transfers are not or have not been approved?**

**Answer:** There are no legal consequences.

**[3] Are they void or enforceable?**

**Answer:** The lack of Commission approval would have no affect on the transfer's voidability or enforceability.

Additionally, although CURB agrees with the arguments and authorities offered by Staff that support the proposition that Commission approval is not needed to transfer or mortgage utility assets, CURB disagrees that the Commission has no power or authority to ensure that such transactions do not interrupt service or impair the reasonableness of rates or the quality of the service rendered to customers. The Commission has sufficient jurisdiction and authority, even in the midst of bankruptcy and foreclosure, to ensure that any transfer of utility assets will not interrupt service or otherwise endanger the continued operation of the utility. See answers to questions (b) and (i), for more detailed arguments on this issue.

**b. What are the rationale for and implications of including a salary for Tim Howison in Howison's operating expenses?**

**Answer:** CURB agrees with Staff that salaries for employees who manage and operate public utilities are a necessary expense, are legitimate components of the cost of serving customers and thus, are normally included in rates. However, in Howison Heights' rate case, CURB has recommended that the Commission order Mr. Howison to hire a qualified water operator to operate the utility, and has included an amount in its recommended revenue requirement to cover that expense, rather than include a salary for Mr. Howison. The evidence is clear that he is not providing sufficient and efficient service to Howison Heights' customers, and is not meeting the minimum standards of record retention and bookkeeping required of any business. While the Commission has generally regarded personnel decisions as the prerogative of utility management, the mismanagement of any utility is well within the legitimate concern of the Commission. In the case of the mismanagement of Howison Heights, the only remedy is to hire

or contract for a new manager of its day-to-day operations. Mr. Howison will continue to receive a margin of profit of approximately 8% that will compensate him for his investment.

Further, contracting out the operation of the utility will go far to relieve the concern that customers might suffer an interruption in service as a result of a change in ownership. With an independent operator who is bound by contract to operate the utility, there will be someone in place to ensure that service is not interrupted and that water quality continues to be monitored.

**c. What is a reasonable salary expense for any entity that operates the Howison water system?**

**Answer:** The answer to this question depends on whether an entity that operates the Howison water system will perform all of the duties required to operate the utility, including performing the tasks of keeping accurate records, isolating the utility's revenues and expenses from non-regulated revenues and expenses, making necessary regulatory filings, paying taxes, etc. To determine the cost of hiring a qualified water operator, CURB used the bids that Howison Heights obtained from two area water operators to support its request for a salary for Mr. Howison. However, the Commission should note that the bids appear to include only the performance of basic operational and maintenance tasks, meter reading, billing and some routine repairs. They don't appear to include any bookkeeping, accounting or management services other than billing customers. CURB believes its recommendation is reasonable for the services described in the bids.

**d. [1] For what reasons did Howison incur the \$496,000 in debt owed to the banks in the Saline County District Court foreclosure proceeding?**

**Answer:** The official record isn't exactly clear on this subject. The bank records that CURB has seen that were filed in the foreclosure proceeding did not contain a great deal of detail on the reasons for each increase in the loans.

**[2] Was the debt incurred to build the water system, or for unrelated business ventures?**

**Answer:** Howison Heights, Inc. was incorporated in 1984. The record shows that Mr. Howison purchased the water system from his father. Howison has expanded the utility to serve 13 more customers than it had when the utility received its certificate of convenience in 2005, and has purchased a standpipe since then. One must presume the expansion and the standpipe cost money, but one should not presume that the source of the funds were the loans at issue in the foreclosure proceeding, without supporting documentation. One promissory note for a \$40,000 loan has a brief notation on it that says the loan was for setting the standpipe. However, the standpipe was not erected, so it is not clear whether the entry is incorrect, whether the money was used for other purposes, or whether \$40,000 was spent on the standpipe project, but was an insufficient amount to complete the project. This promissory note contains the only direct reference among the loan documents to indicate that loan proceeds were used for utility purposes.

However, in spite of the sketchy records, there is a great deal of circumstantial evidence that the loans are related to Mr. Howison's activities as a subdivision developer. Plat filings with the City of Salina (available on the city's website) indicate that he was a co-owner and developer of several subdivisions platted (and re-platted) in Saline County between the years 1998 and 2009. According to Staff, Mr. Howison purchased a total of 320 acres of land in the years 2004 to 2006 to develop the Big Valley Subdivision. The major increases of Mr. Howison's Central

Bank debt occurred in the years 2006 to 2010, increasing the original mortgage from \$110,000 to \$275,000. This period coincides with what is generally known as the period when the “real estate bubble burst”. It would also coincide with the period of time in which it is likely that Mr. Howison incurred considerable expenses for surveying, mapping and jumping the various regulatory hurdles required before the plats could be filed and approved by local officials.

Mr. Howison and his wife retain ownership, in their own names or in the names of corporations, of approximately twenty-five subdivision lots in Saline County, many in the Big Valley Subdivision. One must presume that their continued ownership of these lots is some evidence that the Big Valley subdivision didn't work out so well as some of Mr. Howison's previous developments. It would not be unreasonable to speculate that at least some of the money obtained through promissory notes in the years 2006 through 2010 was spent on Mr. Howison's other business ventures. It would not be unreasonable to speculate that the increases in Howison's debt from 2006 through 2010 are in some part related to the fact that the bottom fell out of the real estate market in about 2006 and has not fully recovered as yet. However, without more evidence, we're simply speculating. The Commission may have to resign itself to perhaps never learning the truth about whether any of the debt was incurred for costs related to the cost of service. But it probably doesn't matter, because where the utility does not present competent evidence to show that the debt was incurred for the purpose of providing service to customers, the costs related to that debt should not be included in customer rates.

**e. Which outcome of the foreclosure case do the parties see as most likely: 1) continuation of the status quo, 2) foreclosure and bank operation, 3) sale to a new owner, or 4) cessation**

**of operations? Further, what effect would each outcome have on rates charged to Howison's customers?**

**Answer:** None of the above options describe what CURB sees as the mostly likely outcome for Howison Heights. Howison Heights has filed for reorganization under Chapter 11 of the bankruptcy code. Filing for bankruptcy automatically stays the foreclosure action and further bars all creditors from making an effort, in court or otherwise, to collect debts from the debtor. The bankruptcy court can grant a motion to lift the stay, but the status quo at this juncture is that the foreclosure action is at a halt. The fate of Howison Heights is in the hands of the federal bankruptcy court, not the Saline County District Court.

Howison's choice to file under Chapter 11 is a signal that the company wants to continue operations and does not want to liquidate assets. One must assume that Howison has filed under Chapter 11 to forestall the foreclosure of the utility properties and to gain some time to renegotiate the repayment terms of the debts. Its creditors will have an opportunity to provide input to the court on the management of the company, the reorganization plan, and other matters relating to the future of the company. The ultimate resolution may be to allow the foreclosure action to proceed, but it is unlikely that the court will do so in the immediate future.

Further, the banks involved in the bankruptcy have agreed, for the time being, not to pursue seizure of payments made to Howison by utility customers, so the utility operations do not appear to be in immediate danger. However, there is no way to know at this juncture whether the creditors and the court will agree to a reorganization plan that would allow Mr. Howison to continue operating the utility. Logically, a bank has no incentive to dive into operating a regulated utility; it's more likely that if the property is transferred to bank ownership that a water operator will be engaged to operate it, and if it is sold to another water utility, it's highly likely

that the new owner will choose to integrate Howison Heights into the new owner's operating structure. Again, that is why ordering Howison to engage an operator to run the utility now is preferable to leaving the question unanswered of who will run it if the new owner is not already a water utility.

**f. What relief could the Saline County District Court grant in the foreclosure proceeding? For example, could the Court direct that whoever acquires the water utility assets provide service to Howison's customers?**

**Answer:** Until and unless the bankruptcy court orders a termination of the stay of the foreclosure action in Saline County District Court, the district court cannot grant any relief to the plaintiffs, the defendants or any other parties. Further, CURB does not believe that the district courts of Kansas have jurisdiction to control or otherwise alter the operation of utility assets regulated by the Kansas Corporation Commission that are dedicated to serving customers. As noted above, CURB believes that the Commission has the power and authority to order any entity that acquires regulated utility assets used in serving customers to continue to provide uninterrupted service to those customers, and to order the purchaser to file an application for a certificate of convenience by a date certain (unless the purchaser is a water utility not within the jurisdiction of the Commission). The Commission also has the power to order the current owner to notify the Commission immediately of the transfer of the ownership of essential utility assets, and order the current owner to provide the Commission contact information for the new owner.

If the bankruptcy court allows the foreclosure action to go forward, one may assume that the bankruptcy court has concluded that foreclosure is an appropriate outcome in the reorganization plan for Howison Heights. However, it is unlikely that the bankruptcy court will

proceed with a reorganization plan without consulting with the Commission as a party in interest and recognizing the jurisdiction and authority of the Commission as a regulator.

**g. What are the regulated water utility assets in these cases?**

**Answer:** CURB concurs with Staff that the regulated water utility assets of Howison Heights are those listed in the depreciation schedule in Howison's rate case application.

**h. What is the chain of ownership and title of Howison Heights, Inc.'s water utility assets? Is there any evidence in property records that these assets are encumbered in any way (e.g., covenants on deeds that indicate the assets are dedicated to the provision of service by a public utility)?**

**Answer:** CURB counsel is not qualified to answer this question, even if it had the deed books and documents at hand to examine. Only a qualified title examiner could answer this question with confidence. As a general matter, however, it is likely that the lenders who issued the original mortgage for the purchase of Howison Heights required title insurance, which assures the lender and the purchaser that the chain of title is clear and that the buyer is advised of any covenants or restrictions that might encumber the use of the land. If so, it may be possible for the Commission to obtain this information from title documents in possession of Howison Heights or the lenders.

**i. Explain in detail whether the obligation to serve Howison's customers follows the water utility assets, and how this would be accomplished in the event of the possible outcomes in the foreclosure case. For example, under what legal authority could the Commission order**



**that the acquirer of the water utility assets become a public utility and continue to provide service to Howison's customers?**

**Answer:** The Commission has broad powers and authority under K.S.A. 66-1,232 to ensure that every water utility governed by the Commission furnishes “reasonably efficient and sufficient service, joint service and *facilities* for the use of any and all products or services rendered, furnished, supplied or produced . . .” [emphasis added]. Notwithstanding Staff’s arguments to the contrary, CURB believes the facilities essential to the rendering of efficient and sufficient service are subject to Commission regulation.

Additionally, K.S.A. 66-1,234 confers the power and authority to the Commission “to investigate, upon its own initiative” the rates and quality of service of a utility, and if it finds that “any service is inadequate or that any reasonable service cannot be obtained,” the Commission has broad powers to order virtually any “just and reasonable” remedy.

When this broad power and authority is read in conjunction with K.S.A. 66-1,237, which states that all grants of power and authority to the Commission “shall be liberally construed, and all incidental powers necessary to carry into effect the provisions of this act are expressly granted to and conferred upon the commission,” it may be assumed that the Commission has ample power and authority to order that the owner of the facilities or the holder of the certificate to provide efficient and sufficient service at just and reasonable rates to the customers served by the utility’s facilities. The only caveat is that the order must be “just and reasonable”.

For example, liberal construction of these statutes would lead to the presumption that the Commission has the authority (and, presumably, the obligation) to order the holder of the certificate of convenience to notify the Commission immediately upon a transfer of assets dedicated to the provision of utility service. The Commission also can order the holder to appear

and show cause why, given the sale or transfer of any asset that is essential to furnishing efficient and sufficient service, the Commission should not revoke the holder's certificate. Similarly, liberal construction of these statutes would lead to the presumption that the Commission has the authority to require the new owner of the facilities to assume the operation of the utility, to serve customers, to file an application for a certificate of convenience, and the power to order any other just and reasonable remedy that will ensure that customers continue to receive sufficient and efficient service at just and reasonable rates. Only if the purchaser is a utility outside the jurisdiction of the Commission would the Commission be barred from enforcing orders against the new owners.

Thus, while Commission approval is not required to mortgage or transfer utility assets, the Commission not only has the power but the obligation to ensure that the customers served by those assets continue to receive sufficient and efficient service at just and reasonable rates, and presumably may extend its authority over the new owner and the utility assets themselves, even if the certificate of convenience does not transfer along with the ownership. Such actions are permissible in the exercise of the "incidental powers" conferred on the Commission by the legislature to carry out the purposes of the public utilities act. The Commission has no real interest or authority in who owns the facilities, but has the obligation and authority to ensure that the facilities dedicated to providing water service to Howison's customers continue to be dedicated to providing that service—until and unless the utility has proven that it can meet its obligations to provide that service in some other way.

The Commission may also exert its power and authority over the mortgage of utility assets if the transaction impairs the ability of the utility to provide sufficient and efficient service at just and reasonable rates. It cannot stop or void the mortgage, but it can mitigate the damages

to customers. For example, if the Commission found that the transaction was unreasonably expensive, that the transactional costs have rendered rates unreasonable, or that the transaction has subjected the utility's finances to unreasonable risk, the Commission could order any just and reasonable remedy, such as excluding excessive costs from the cost of service, reducing the rate of return, or ordering the utility to undertake actions to mitigate the risk.

In summary, while the Commission has no power to stop or reverse a transfer or mortgage of utility assets, it has broad powers and authority over the use and operation of the assets that are dedicated to serving customers, and broad powers and authority over not only those it has given prior authorization to operate the utility but also those who acquire an interest in those assets—and that it is clear that the legislature intended the Commission to have a wide latitude in determining appropriate remedies in exercising its obligations to ensure that customers receive sufficient and efficient service at just and reasonable rates.

Further, the Commission should not be too concerned that the jurisdiction of the bankruptcy court will supplant the jurisdiction of the Commission. “Dire projections about the effects of a utility bankruptcy are largely unfounded,” says Theodore Eisenberg, who cautions regulators not to yield to fears that a bankruptcy court will strip the regulatory agency of any power to prevent disaster. (T. Eisenberg, *Bankruptcy in the Administrative State*, J. of Law and Contemporary Problems, Vol. 50: No. 2, at p. 20; p. 9 (1987). He posits that the business of a regulated utility is so “intertwined” with regulation that “The business cannot be viewed independently from the regulatory structure to which it is subject. If [a utility] initiates a bankruptcy proceeding, the proceeding will have to take account of the special regulatory structure applicable to the debtor.” *Id.*, at 12. Eisenberg notes that while some regulated industries (railroads, banks) have special provisions in the bankruptcy code to deal with their

unique problems, the bankruptcy code provides that the filing of a petition for bankruptcy of a utility does not stay regulatory proceedings of the utility commission with jurisdiction, nor does it prevent it from commencing new proceedings; the code provides that the trustee or other manager of the bankruptcy should “operate property in accordance with the law of the state where the property is located.” *Id.*, at 12. That is an implicit recognition in the bankruptcy code of other regulatory regimes that have jurisdiction over the utility.

Generally, Eisenberg concludes that while a bankruptcy court has no obligation to defer to the preferences of a regulatory commission in developing the reorganization plan, the court has good reason to take into account the commission’s concerns and obligations, and has no incentive to deprive the commission of its regulatory authority. Not only creditors, but interested parties are allowed to intervene, such as regulatory commissions or representatives of customer groups, such as CURB, and their opinions are routinely solicited in developing a reorganization plan.

The Howison Heights bankruptcy appears to be a good candidate for a fairly swift development of a reorganization plan. The interest of the plaintiff is identical with the sole shareholder (Mr. Howison is owner and sole shareholder), so there is no potential conflict to resolve between the company and its shareholders. CURB has no budget to get involved in the bankruptcy on behalf of ratepayers, further reducing the number of negotiating parties. Thus, given its expertise and authority, the Commission might become a key player in the development of a reorganization plan if it participated in the case as a party-in-interest. The Commission may provide valuable input that will make it less likely that the reorganization plan approved by the court will impede the ability of the utility to serve customers or to meet its other regulatory obligations.

Further, as Eisenberg points out, when a monopoly utility files bankruptcy, there is no danger of a mass migration of customers away from the bankrupt company (as they would be likely to do if their bank went bankrupt, for instance), so the utility will continue to collect revenues even if the reorganization phase is prolonged. "So long as ratepayers pay their bills and use the utility's product, prospects for ultimate failure are small," he says. *Id.*, at 14.

Additionally, often one of the first items to be addressed in a reorganization proceeding is the competence of management. *Id.*, at 23. Since this issue has been at the forefront of concerns of CURB and the customers it represents, and is a continuing concern of Staff and the Commission itself, the bankruptcy process may prove useful in addressing Howison's management problems. While CURB believes the immediate solution is to contract with a qualified water operator to run Howison Heights, the Commission may have ideas of its own to bring to the table in the reorganization process.

Eisenberg also notes that changes in bankruptcy law over the years have helped ensure that a utility's cost of debt in a post-bankruptcy world isn't unreasonably high, because lenders who are willing to step up and provide loans in the wake of a bankruptcy are now given priority over pre-bankruptcy lenders. *Id.*, at 15-17. The reduced risk for post-bankruptcy lenders can result in post-bankruptcy debt costing less than the debt that precipitated the bankruptcy. *Id.*, at 17. This is good news for customers of bankrupt utilities that will continue to need access to capital, especially in this period of relatively low interest rates.

In short, there is no need to fear that a bankruptcy is an unmitigated disaster for regulators, the customers or the utility itself. As has been demonstrated already in Howison's bankruptcy case, the creditors have agreed, at least for now, not to make claims on utility revenues, which appears to be an implicit recognition by the banks of Howison's obligation to

continue serving customers during the bankruptcy proceedings. Meanwhile, the Commission retains its regulatory authority over Howison, and could order the utility to hire a qualified water operator to ensure that regardless of who ends up owning the utility, or how long it takes to complete the reorganization plan, customers will continue to receive uninterrupted service. Neither the banks nor the courts have incentives to supplant or deny the Commission's regulatory authority, and, indeed, may welcome its continued involvement in the reorganization process to ensure that Howison's customers are protected from loss of water service and unreasonable rates. These bankers do not want to run a water utility. Bankers do not want to dig in the ground and fix leaky pipes. More importantly, no bank wants to be deemed responsible for rendering an entire subdivision in its community uninhabitable for lack of water service. That's simply bad business, especially in a smaller community. The banks have sufficient incentive to keep Howison viable, regardless of whether it is sold to a new owner or reorganized so that its debts can be paid back. If the banks perceive the Commission as an ally in wanting to keep Howison viable, there is reason to believe that this bankruptcy will succeed in reorganizing the utility's debt in a manner that ensures that Howison meets its obligations to customers.

Eisenberg's message for utility commissions facing a bankruptcy of a utility under their jurisdiction could be summarized as "Keep calm and regulate." The Commission should not be overly concerned that this bankruptcy will rob it of power to protect the customers. The Commission can help ensure that doesn't happen by intervening in the bankruptcy and providing valuable guidance to those involved in developing Howison's reorganization plan.

Respectfully submitted,

A handwritten signature in black ink, appearing to be 'D. Springe', written over a horizontal line.

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**VERIFICATION**

STATE OF KANSAS                             )  
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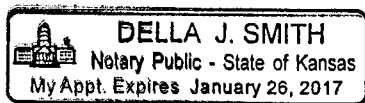
I, Niki Christopher, of lawful age, being first duly sworn upon her oath states:

That she is an attorney for the above named petitioner; that she has read the above and foregoing Intervention, and, upon information and belief, states that the matters therein appearing are true and correct.

*Niki Christopher*

\_\_\_\_\_  
Niki Christopher

SUBSCRIBED AND SWORN to before me this 19<sup>th</sup> day of August, 2013.



*Della J. Smith*  
\_\_\_\_\_  
Notary Public

My Commission expires: 01-26-2017.



**CERTIFICATE OF SERVICE**

13-HHIW-570-RTS/13-HHIW-460-GIV

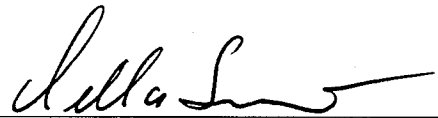
I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was served by electronic service on this 19<sup>th</sup> day of August, 2013, to the following parties who have waived receipt of follow-up hard copies:

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