

Service Date: September 26, 1991

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

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IN THE MATTER of the Application )  
of the City of Great Falls for ) UTILITY DIVISION  
Authority to Increase Rates and ) DOCKET NO. 90.10.66  
Charges for Sewer Service to its ) ORDER NO. 5522j  
Great Falls, Montana, Customers. )

APPEARANCES

FOR THE APPLICANT:

David Gliko, City Attorney, City of Great Falls, P.O. Box 5021  
Great Falls, Montana 59403-5021.

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34  
West 6th Avenue, Helena, Montana 59620.

Lt Col Bruce Barnard, Attorney-at-Law, Federal Executive  
Agencies, HQ USAF/ULT, Stop 21, Tyndall AFB, Florida  
32403-6001.

Robert Goff, Attorney-at-Law, Montana Refining Company,  
Third Floor, Norwest Bank Building, P.O. Box 1645, Great  
Falls, Montana 59401.

Patrick Flaherty, Attorney-at-Law, Montana Peoples Action,  
625 Central Avenue West, Great Falls, Montana.

FOR THE COMMISSION:

Tim Sweeney, Staff Attorney, 2701 Prospect Avenue,  
Helena, Montana 59620.

Ron Woods, Rate Analyst, 2701 Prospect Avenue, Helena,  
Montana.

BEFORE:

BOB ANDERSON, Commissioner and Presiding Officer  
JOHN DRISCOLL, Commissioner  
WALLY MERCER, Commissioner

BACKGROUND

1. On November 5, 1990, the City of Great Falls (Applicant

or City) filed an application with this Commission for authority to permanently increase sewer rates for its Great Falls, Montana, customers by approximately 63.17%, constituting an annual revenue increase of approximately \$1,651,700.

2. Concurrent with this filing for a permanent increase in rates, the City filed an application for interim rate relief. The City requested an interim increase in rates of 25.72%, equalling a revenue increase of approximately \$672,500 or 40.7% of the proposed permanent increase.

3. On November 28, 1990, the Commission, having considered the testimony and exhibits submitted by the City in support of its interim rate application, issued Order No. 5522 granting the City interim relief in the amount of \$505,425.

4. During the course of this proceeding the Commission issued Order Nos. 5522a, through i. These orders addressed procedural or legal issues pertinent to the proceedings.

5. On April 26, 1991, the City filed an amended petition for sewer rate increase. The amended petition reduced the amount of the annual revenue increase requested from \$1,651,700 to \$1,333,400.

6. On May 29, 1991, following issuance of proper notice, a hearing was held in the Civic Center, Great Falls, Montana. For the convenience of the consuming public a session was held at 7:00 p.m., May 28, 1991, at the same location. The purpose of the public hearing was to consider the merits of the Applicant's proposed sewer rate adjustment.

#### ANALYSIS AND FINDINGS OF FACT

7. At the public hearing the Applicant presented the testimony and exhibits of the following witnesses:

John Lawton, City Manager,  
Erling Tufte, Public Works Director

Tim Magee, Finance Director  
John Gallagher, Consulting Engineer  
Craig Nowak, Consulting Engineer  
Chris Hosler, Consulting Engineer

These witnesses testified on the current financial condition of the sewer utility, the need for the proposed capital improvements, the estimated cost of the proposed capital improvements, the financing of proposed capital improvements, the cost-of-service study and rate structure.

8. The Intervenors in this Docket presented the testimony of the following expert witnesses:

Frank Buckley, Rate Analyst, Montana Consumer Counsel  
Jerome Mierzwa, Consultant, Federal Executive Agencies  
Thomas Catlin, Consultant, Federal Executive Agencies

These witnesses testified on the current and projected financial statements of the sewer utility, proposed modifications to the City's cost-of-service study and rate design modifications.

9. Montana Peoples Action (MPA) and the Montana Consumer Counsel (MCC) presented the testimony and exhibits of 17 public witnesses during the course the hearing. The majority of these public witnesses expressed concerns about rate impacts on fixed income subscribers, the estimated cost of the long-term capital improvement program, the possibility that sewer utility funds had been transferred to other funds thus necessitating this increase, and presented a petition with 4,300 signatures opposing the rate increase. Three of the public witnesses testified in support of the proposed increase in sewer rates indicating that, in their opinion, utility facilities were in need of capital maintenance.

#### CAPITAL IMPROVEMENT PROGRAM

10. In prefiled testimony and exhibits the City set forth a proposed 10-year capital improvement program for the sewer utility. As outlined by the City the total estimated cost of the 10-year capital improvement program is \$34,466,100 (Exhibit G.F. 12, p. 2-6). This amount includes the repayment of \$238,300

borrowed from the City's central garage fund to finance capital improvements to the sewer system during FY 1990. As presented in the documents filed with the Commission, the 10-year capital improvement program, and attendant funding, appears to be under consideration by the Commission in this Docket. However, that is not the case.

11. The Commission's jurisdiction relative to the capital improvement program is defined by the City's rate increase application which requests that the Commission authorize revenues sufficient to service debt on capital improvements, including those financed with the central garage fund loan, proposed during the 2 fiscal years subsequent to issuance of an order in this Docket. The City has limited its rate request to funding the items described in the previous sentence; therefore, Commission authority to accept or reject all or part of the capital improvement program is confined to that time period.

12. The City proposes that the bulk of the capital improvements under consideration in this Docket be funded from a Revenue Bond issue having a term of 20 years and a maximum interest rate of 8.0 percent, with the requirements that the City have a reserve fund in an amount equal to one year's principal and interest payment on the bond, and provide debt service coverage of at least 125%.

13. The City's proposed sewer system improvement program is presented in the Sewer Mini-Master Plan, City of Great Falls Exhibit No. 9, prepared by Delta Engineering, August, 1990. City witnesses testified that the sewer system improvement plan identifies needed improvements to the following: treatment facilities, lift stations and the collection system. The mini master plan was not based on a comprehensive examination and analysis of the city's sewer facility. Much of the information reported in the improvement plan was provided by the city's department of public works. The report indicates that the majority of the proposed capital improvements and associated costs were identified by utility operating and management

personnel and subsequently reviewed by the consultants. The consultants indicate that they made "additional recommendations based upon an assessment of sewer main video tapes and a review of the treatment equipment."

14. Table 1 sets out the proposed costs, by operational function, associated with the capital improvements program.

TABLE 1

1. Treatment Facility	\$1,110,900
2. Collection System	\$6,877,700
3. Capitalization of Reserve Fund	\$ 937,000
Total	\$8,082,600*

\*Costs are 1992 and 1993 dollars

15. SEWAGE TREATMENT. As defined in the Mini-Master Plan, sewage treatment improvements include projects at the treatment facility and improvements to the lift stations on the collection system. The City witnesses asserted that the sewage treatment facility required replacement of numerous pieces of capital equipment during fiscal years 1992 & 1993. Examples are pumps, motors, bar screens, valves, air compressors, telemetry, boilers, and grit washers.

16. To validate the need for improvements at the treatment facility and lift stations the consultants conducted an equipment needs assessment by having the City staff provide a comprehensive list of lift station and treatment plant equipment, buildings and associated facilities. The list included the year of installation, expected service life and estimated replacement cost. Based on this list of a total of 408 items, Environmental Operating Services (EOS) and Delta Engineering (Delta) sampled 51 of the items to ascertain the expected life and replacement cost.

17. As reported by Delta, in City Exhibit No. 9, "...it was determined that the actual useful life of many items was less than the expected (design) life by approximately 1.2 years." Delta using this determination, systematically adjusted the replacement date for many items into earlier years.

18. Montana Refining Company (MRC) challenged the credibility of the equipment assessment study conducted by EOS and Delta. During cross-examination of City witness Craig Nowak, MRC attempted to establish the statistical validity of the sample equipment group chosen for the survey. Mr. Nowak indicated during this examination that he was unable to describe the procedure used by EOS to select sample items for the survey. The witness's inability to describe EOS's sample selection procedure prompted the request for the late filing of an exhibit describing the selection process.

19. The City's late-filed exhibit 1 describes the equipment selection process used by EOS and relied on by Delta to determine that useful life is less than design life. In the exhibit the city provides this quote from EOS's own information: "The items listed have been determined to have the highest priority for repair and/or replacement." EOS's equipment selection process was clearly not random.

20. The failure of EOS to use a random equipment selection process for the sample introduces an inherent bias into the assessment and destroys the credibility of the determination that useful life is less than design life by 1.2 years. The integrity of the long-term capital improvement schedule for treatment and lift stations is invalid. However, the need for proposed improvements to treatment plant and lift stations during the next two fiscal years is reinforced, because the selection process chose those items with the highest priority for replacement.

21. COLLECTION SYSTEM. In Appendix C1, City Exhibit No. 9, the City identifies the proposed construction projects to be completed during FY 92 & 93. The FY 92 & FY 93 construction program will include 50% and 25%, respectively, of the construction proposed to be undertaken in FY 91 that was deferred due to insufficient funds. The proposed construction projects include system improvements, rerouting of collection mains and collection main replacements. No significant opposition to the

proposed collection system improvements was presented by any party to this proceeding.

22. City witnesses indicated that portions of the sewer utility collection system are in need of replacement or rehabilitation due to system deficiencies. Some of the collection system problems identified by witnesses include collection line failures that could cause blockage in sewage flow, collection lines operating at capacity, deteriorated manholes that are becoming unsafe to enter, cracked or damaged sewer lines that are allowing infiltration-exfiltration, and root intrusions.

23. Two of the system improvements proposed to be completed, the West Side Interceptor and the Verde Park Relief, involve joint funding between the City and the Environmental Protection Agency (EPA). The City will fund 55% of the overall project costs and the EPA will provide the balance. The City indicated that the EPA is participating in the funding of these projects because of the deteriorated condition of the existing facility and the potential environmental/health consequences of a failure involving these facilities. The EPA participation in funding the West Side Interceptor project is presently in jeopardy because of the City's delay in providing matching funds to construct the facilities.

24. DEBT REPAYMENT. During FY 1990 the sewer utility, with the approval of the City Commission, borrowed \$238,300 from the central garage fund of the city to make repairs and improvements to the water system. The loan agreement provided that the loan would bear interest at the rate of 8.10% per annum, until paid.

25. MRC questioned the City witnesses relative to the underlying rationale for the execution of a loan agreement between City funds and associated interest costs. MRC's cross-examination revealed that it was of the opinion that the loan proceeds should not have to be repaid to the central garage fund. MRC established that the City's central garage fund was a

discretionary fund created by the City Commission to accumulate a capital reserve for vehicle and equipment replacement. MRC further established that various City departments participate in the funding of this reserve. MRC therefore, asserted that the discretionary nature of this fund should afford the City the ability to spend the monies in the reserve for improvements to utility facilities without a repayment obligation.

26. The assertion that the City can at its discretion expend funds collected from various city departments on utility improvements is rejected by the Commission. Fiscal accountability requires that monies collected from various departments and maintained in an earmarked account be expended for the stated purpose for which the reserve account was created.

27. City witnesses argued that the assessment of interest on the central garage fund loan was appropriate. Witnesses stated the funds in the reserve would have been invested and earned interest if the proceeds had not been loaned to the utility. The City witnesses explained that historically this reserve was invested in CD's, or some other secure investment, for the purpose of reducing assessments to the various departments. The assessment of interest on the monies borrowed from the central garage fund is found to be reasonable to the extent that the monies borrowed from the fund do not represent accumulated reserves of the utility.

28. The Commission finds, based upon the testimony in this Docket, that the capital improvement program as proposed by the City of Great Falls is prudent and therefore accepts the City's assertion that the improvements outlined in the filing need to be constructed. The Commission further finds that repayment of the central garage fund loan with interest, except for interest on utility funds, is reasonable.

29. With regard to the EPA projects, it is not in the best interest of the ratepayers for the City to lose the federal participating funds. The City should, as expeditiously as

possible after receipt of this order, obtain the necessary matching funds to construct these projects.

#### DEBT SERVICE

30. The City proposes to finance the capital improvements outlined in Table 1 of this Order, in part, through the issuance of revenue bonds. The City proposes to issue \$9,200,000 in revenue bonds to be repaid over a period of 20 years with the requirements that the City capitalize from the bond proceeds a reserve fund in an amount equal to one year's principal and interest payment on the bonds and that it provide a debt service coverage of 125 percent.

31. The Applicant has a current outstanding sewer revenue bond with an annual principal and interest payment of approximately \$426,100 and a present coverage ratio requirement of 125%. The City does not anticipate retiring this bond issue with the issuance of the proposed \$9,200,000 revenue bond issue. Therefore, the City will be incurring bond payments that are additional to those described in the preceding Finding of Fact. Since the City will not be retiring the current outstanding revenue bond it will have to comply with the requirements outlined in the current Revenue Bond Ordinances regarding the issuance of additional revenue bonds.

32. In any sale of municipal bonds, the purchasers of the bonds must be assured that their investment is secure. To provide this security the municipality makes a promise, called a covenant, to do certain things that will ensure that it will always be able to pay the bond's principal and interest as they come due. In this instance, the City proposes to include covenants agreeing to establish a bond reserve fund in an amount equal to one years principal and interest payment on the bond, amounting to \$937,000, and provide a debt service coverage ratio of 125 percent.

33. The Commission finds the bond covenants, establishment of

a reserve fund and the 125 percent coverage ratio, to be among the standard requirements for the issuance of revenue bonds and therefore accepts the requirements.

34. The Commission finds the issuance of \$9,200,000 in revenue bonds with a maximum term of 20 years and a maximum interest rate of 8.0 percent, with the requirements that the City establish a bond reserve in an amount equal to one year's principal and interest payment on the bonds and debt service coverage of 125 percent, to be appropriate.

35. When the City completes the sale of the proposed revenue bonds it will incur an annual principal and interest payment on all outstanding revenue bonds of approximately \$1,363,100. It will also incur the obligation of having a net operating income of at least \$340,775 to meet the requirement that it achieve a 125 percent coverage ratio. To determine net operating income, operation and maintenance expense, as well as debt service, are subtracted from the total revenues of the utility. The required net operating income is calculated by multiplying the annual principal and interest payment on outstanding bonds by 25 percent ( $\$1,363,100 \times .25 = \$340,775$ ).

#### OPERATING REVENUES

36. The Applicant proposed test period operating revenues of \$2,614,800. The MCC contested the Applicant's proposed test period operating revenues. MCC's expert witness Frank Buckley contended that the City's these revenues should be increased by \$110,605.

37. The MCC proposed three adjustments increasing the Applicant's operating revenues:

- 1) Increasing "Storm Drain Charges" payable to the utility by \$15,000 to reflect budgeted payments from the storm drain utility to the sanitary sewer utility.
- 2) Increasing normalized sewer utility revenue by

\$62,700 to reflect the omission of sewer utility payments from Montana Refining Company.

- 3) Increasing utility revenues by \$32,905 to reflect a normalized revenue level for extra strength surcharge assessment.

38. In his prefiled direct testimony Mr. Buckley recommended that the sewer utility revenues be increased by \$15,000. Mr. Buckley indicated that the City had budgeted a payment of \$115,000 from the storm drain utility operation to the sanitary sewer but only reflected a \$100,000 payment in the filed financial information. After reviewing responses to data requests submitted subsequent to filing of his testimony, Mr. Buckley withdrew this proposal. He indicated that he was satisfied that this \$15,000 payment was a non-recurring item.

39. In researching responses to data requests promulgated by Montana Refining Company (MRC) the City determined that it had failed to include payments from MRC to the sewer utility in its operating revenues. Mr. Buckley in his testimony proposed increasing operating revenues by \$62,700 to reflect this omission. The City did not challenge this proposal; therefore, the adjustment is accepted by the Commission.

40. During examination at the hearing the City's witness Tim Magee indicated that the financial information submitted to the Commission included annual revenues of \$4,900 as the normalized extra strength revenue for the sewer utility. Under cross-examination and in responses to data requests, Mr. Magee indicated that the actual extra-strength revenue of the utility, FY 91 year to date, was approximately \$35,000.

41. Based on the responses to data requests and witness examination, the MCC requested that the City submit a late-file exhibit detailing for FY 91, by customer, payments received by the utility for extra-strength assessments. The late-filed exhibit indicates that the City received total payments of \$37,805 for this assessment.

42. Based on the late-filed exhibit and responses by the City, the MCC asserts that the \$4,900 normalized revenue level included in the financial information for this assessment does not fairly represent the revenues that can be expected. The Commission concurs with the MCC. There is little historical data relative to this assessment; therefore, the best evidence of its ability to generate revenue is the information contained in the late-filed exhibit submitted by the City. This exhibit indicates that the City received \$37,805 in revenue from the assessment. The financial information filed with the Commission reflects \$4,900. The Commission finds that the operating revenue of the utility should be increased by \$32,905.

43. Based on the above adjustments to operating revenues, the Commission finds the test period operating revenues of the utility to be \$2,710,405.

44. The sewer utility will generate interest income through investment of its bond reserves. The Applicant calculated that it would generate approximately \$30,000 in interest income on an annual basis. This calculation was reviewed and not contested by any party participating in this proceeding and is accepted by the Commission.

45. The Commission, based upon the preceding Findings of Fact, therefore finds that the total revenues of the utility are \$2,740,405.

#### OPERATION AND MAINTENANCE EXPENSE

46. The Applicant proposed net test period operation and maintenance expenses of \$2,274,300. The test period operation and maintenance expenses proposed by the Applicant are net of miscellaneous revenue.

47. The MCC proposed two adjustments to the Applicant's normalized test period operation and maintenance expenses increasing expenses by a total of \$17,075. The MCC's expert

witness proposed the following adjustments:

- (1) Increasing the sewer utility's operating expenses by \$48,075 to reflect an appropriate distribution of salary and wages of common employees of the water/sewer utility.
- (2) Reducing expenses by \$31,000 to reflect a refund from Environmental Operating Services per contract with the treatment plant operator.

48. The City agreed, in principle, with the MCC's proposal that a redistribution of salary and wages for common water/sewer utility employees is appropriate. However, it has not accepted that the expenses of the sewer utility should be increased.

49. Utility operations of a local government are enterprise funds and, as such, should be self-supporting. The City has indicated in responses to data requests, and in testimony, that several employees in the public works department have common job responsibilities between water and sewer utility operation. Consumers of the City sewer utility service should be responsible for payment of expenses that are appropriately chargeable to the sewer utility. Therefore, the Commission finds that the expenses of the sewer utility should be increased by \$48,075.

50. During his testimony Mr. Buckley withdrew his proposal to reduce operating expenses by \$31,000 to reflect a refund from contract treatment plant operator. Mr. Buckley indicated that he was now satisfied that reported contract payments to Environmental Operating Services were net of the \$31,000 refund.

51. The Commission finds, based upon the preceding Findings of Fact, that the Applicant's net normalized test period operation and maintenance expenses are \$2,322,375.

52. The Commission, based upon Findings of Fact contained herein, finds that the Applicant should be allowed to increase annual revenues by \$1,285,845. This requirement is calculated as follows:

Operating Revenues	\$2,740,405
Less:	
Operating Expenses	\$2,322,375
Debt Service	1,363,100
Debt Service Coverage	340,775
Total Revenue Requirement	\$4,026,250
REVENUE DEFICIENCY	\$1,285,845

#### RATE DESIGN

53. The Commission, by separate order, will discuss the issue of cost of service and rate design in this Docket. The rate design order will be issued by the Commission no later than November 18, 1991.

#### MISCELLANEOUS

54. During these proceedings the City provided certain inaccurate financial and statistical information to the parties. It is the Commission's understanding that the source of the inaccurate information was the City's finance/accounting department. The City needs to review its financial/accounting internal controls insofar as they relate to the City's public utility operations.

55. While not a subject that received significant attention in this proceeding, because of its impending termination date, the contract with EOS does warrant comment. The existing contract between the City and EOS is a cost plus contract, i.e., EOS is guaranteed a profit margin. A cost plus contract is not the most desirable contract nor is it in the best interest of the ratepayer. Because a cost plus contract guarantees a profit it provides a contractor with no incentive to operate efficiently. The Commission would recommend, since the termination date of the present contract is nearing, that the City modify the terms and conditions of any prospective agreement with an operator and provide incentives to operate efficiently. The implementation of another cost plus arrangement with an operator will not provide

that incentive. This discussion should not be viewed as an opinion that the present treatment plant operator is not operating efficiently.

56. One of the concerns expressed by MPA was the possibility that sewer utility funds had been transferred to other funds thus necessitating the need for its increase. During its discovery audit of the books and records of the City of Great Falls the Commission staff found no indication of improper transfer of utility funds. The Commission is reasonably satisfied that the City has not used fund transfers as a basis for justifying an increase in utility rates.

#### DISCUSSION

The majority of the proposed capital improvements to be undertaken by the City are beyond the scope of this order and in all probability will not be subject to the scrutiny of this Commission. Increases necessary to fund prospective improvements will, in all probability, be the jurisdiction of the local government.

The public and MPA questioned the overall cost and necessity for capital improvements that are proposed to occur within the next 10 years. Witnesses indicated that they were concerned about the ability of consumers to pay for the aggressive long-term capital improvement. The public should understand that the 10 year capital improvement program prepared and presented to the Commission will be subject to significant modification on a prospective basis. Prior to determining a need for additional capital improvements public policy and good management practices dictate that the planning document be reviewed and updated and that the consuming public has a meaningful voice in the decisions.

During this review process the City, through its staff and City Commission, should insure that the proposed improvements are both necessary and cost-effective. Public involvement in the

planning process should be sought and encouraged by the City to ensure the broadest base of involvement possible.

The City, in its deliberations on capital improvements, should be cognizant of the rate shock that will be experienced by subscribers, especially fixed and low income subscribers. One of the major concerns expressed during the hearing was the economic impact that implementation of increased rates would have on consumers. The Commission shares this concern and believes the City does as well. But, for the reasons outlined in this order, the Commission has found that the City of Great Falls must generate increased revenues from its consumers.

#### CONCLUSIONS OF LAW

1. The Applicant, the City of Great Falls, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's rates. Title 69, Chapter 7, MCA.

2. The Commission has provided adequate public notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates and rate structure approved in this order are just and reasonable. Sections 69-3-201, and 69-3-330, MCA.

#### ORDER

THEREFORE THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. The revenue increase authorized herein is, in lieu of, not in addition, to that authorized in Order No. 5522.

2. The City of Great Falls is authorized to issue revenue bonds in the amount of \$9,200,000 with the requirements as outlined in Finding Fact No. 34.

3. The revenue increase approved herein shall not become effective until the tariffs, revenue bond ordinance(s), and necessary calculations relating to debt costs have been submitted for review by the Commission.

DONE IN OPEN SESSION at Helena, Montana, this 23rd day of September, 1991, by a 3 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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WALLACE W. "WALLY" MERCER, Commissioner

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JOHN B. DRISCOLL, Commissioner

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BOB ANDERSON, Commissioner

ATTEST:

Ann Purcell  
Acting Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.