

Service Date: March 15, 1991

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

\* \* \* \* \*

IN THE MATTER of the Application )  
of Valley West Water Company for )  
Authority to Increase Rates and )  
Charges for Water Service in its )  
Missoula, Montana Service Area. )  
\_\_\_\_\_ )

UTILITY DIVISION  
DOCKET NO. 90.5.30  
ORDER NO. 5494a

\* \* \* \* \*

PROPOSED ORDER

APPEARANCES

FOR THE APPLICANT:

George Devoe, Attorney at Law, 7700 Pine Hill Court, Missoula, Montana 59802.

FOR THE INTERVENORS:

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

Jim Nugent, City Attorney, City of Missoula, 435 Ryman, Missoula, Montana 59802.

FOR THE COMMISSION:

Martin Jacobson, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620.

Ron Woods, Rate Analyst, 2701 Prospect Avenue, Helena, Montana 59520.

BEFORE:

Howard Ellis, Commissioner and Hearing Examiner

### BACKGROUND

1. On May 8, 1990, Valley West Water Company (Applicant or VW) filed an application with this Commission for authority to increase water rates and charges to its Missoula, Montana customers on a permanent basis by approximately 96%. This constitutes an annual revenue increase of approximately \$25,823.

2. Concurrent with its filing for a permanent increase in rates, VW filed an application for an interim increase in rates of 96% equaling a revenue increase of approximately \$25,823, or 100% of the proposed permanent increase.

3. On September 7, 1990, the Commission, having considered the data filed with the Applicant's interim application, issued Order No. 5494 granting the Applicant interim rate relief in the amount of \$12,968 annually.

4. On November 20, 1990, following a notice of public hearing, a hearing was held in the City Council Chambers, City Hall, Missoula, Montana. For the convenience of the consuming public there was a night session at the City Hall commencing at 7:00 p.m. the same day. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustment.

5. VW provides water service at the northern end of Reserve Street, Missoula, Montana. The construction of the water system operated by VW was financed through special improvement district (SID) assessments that were/are paid for by owners of properties in VW's service area. The City of Missoula owns the water system operated by Valley West. By lease agreement the City of Missoula transferred the responsibility for operating and maintaining this water facility to a private entity in 1981. Construction of the utility plant in service was financed through an SID, therefore, VW had no investment in the utility plant that existed as of 1981. The information provided during the hearing indicates that since the date of acquisition of this utility by the operators no additional capital investment that would establish a rate base has occurred. The information in this finding is provided so that parties will have an understanding why the Commission is not affording this privately operated utility the generally accepted rate base treatment for determining reasonable rates.

### ANALYSIS AND FINDINGS OF FACT

6. At the public hearing the Applicant presented the testimony and exhibits of:

Deborah Palmer, Bookkeeper/Accountant, VW  
Jim Gillan, Certified Operator, VW

These witnesses testified relative to: the financial statements of the utility, management of the system and projected increased costs of operating the utility.

7. During the course of the public hearing six public witnesses appeared and offered testimony regarding VW's rate increase application. These public witnesses expressed opposition to the Applicant's proposed rate structure, concerns regarding perceived inaccuracies in the financial and operating information presented to the Commission, inadequate fire flows, and alleged mismanagement.

8. In this application VW has requested that the Commission authorize an increase in rates that will generate approximately \$25,823 in additional annual revenues. The Applicant's witness, Ms. Palmer, stated that the increase in revenues sought in this application were needed to defray increased costs of operation and to reduce operating losses currently being experienced by the VW.

9. As part of the late-filed exhibits required to be filed by the Applicant, VW provide the Commission with its latest actual year operating statement. This exhibit indicates that for the year ending June 30, 1990, VW posted an actual operating loss of \$8,949. An examination of VW's annual reports filed with this Commission indicate that the Applicant sustained losses of \$11,717, \$16,620, and \$11,169 for the years 1987, 1988 and 1989, respectively. Ms. Palmer's assertion that VW is experiencing operating losses is clearly supported by these reports to the Commission. Based on the information enumerated above the Commission finds that during the four year period the Applicant has sustained average operating losses of \$12,114.

10. In its post hearing brief the City of Missoula (City or Missoula) attacks the veracity of the operating statements provided the Commission in this filing on a number of grounds and requests that the Commission reject the validity of the information.

11. In its brief the City refers the Commission to the federal tax returns of VW and operating losses reported thereon. The city cites to discrepancies between the losses reported on

the tax returns for the years 1989 and 1990 and the losses reported to the Commission for the same period. The City incorrectly compared reported losses from the late-filed tax return exhibits, that are for the years 1988 and 1989, to the reported losses for 1989 and 1990 provided to the Commission. The City's assertion that the Applicant's financial information be found invalid because of this reporting discrepancy is without merit. It is not unusual for a utility's tax return information to differ from ratemaking financial information because of tax timing differences in the reporting of certain information.

12. The City also asserted that the Applicant's financial information should be found invalid because of discrepancies in the customer count information provided the Commission. The City, as well as public witnesses, alleged that the Applicant's final calculation of annual revenue did not reflect all of the consumers connected to the system. The Commission requested that the Applicant and the Consumer Counsel, through the home owners association, provide the Commission with a listing of customers currently connected to the system. The information provided by the Company indicates that as of 12/4/90 the utility has 22 commercial accounts and 56 residential. The information provided by the home owners association to the MCC indicates that there are 55 residential connections and potentially 27 commercial connections (the home owners did not know how many commercial accounts were physically connected to the system therefore, they provided a listing of potential connections). The late-filed information submitted by the parties indicates that no significant disparity in customer count presently exists.

13. For purposes of calculating projected revenues in this Docket the Applicant used a total customer count of 73, five fewer than the customer count of 78 as of 12/4/90. The difference in the customer count information indicates that VW has understated the revenues that would be generated through current rates and charges. For purposes of calculating revenue needs the Commission will increase the current annual revenues of VW by \$490. The \$490 revenue increase is calculated using the average monthly residential rate (\$8.17) times the 5 additional customers times 12 months.

14. Based on the information provided during this proceeding the Commission finds the Applicant's test year operating revenues under rates effective prior to September 28, 1990 to be

\$28,002. This amount includes the additional \$490 found appropriate in the previous Finding of Fact.

#### OPERATION AND MAINTENANCE EXPENSE

15. Based on the 1990 operation and maintenance expense information submitted by the Applicant as a late-filed exhibit the Commission concludes that VW is incurring operating expenses of \$33,015 annually.

16. In this application VW has projected that its expenses, adjusted for known and measurable changes, will increase to \$58,348. This means that the Applicant increases of \$25,333 annually.

17. As indicated by the City in projected annual expense increases speculative and not supported by substantial evidence.

18. VW in its projected operating statement indicated that it would be experiencing an increase in electrical utility expense of \$3,713. VW states that the increased electrical expense represents "an allowance for additional electrical charges necessitated by an ever increasing customer base." The Applicant by making this adjustment has violated the matching principle of ratemaking, i.e. VW included the increased expense associated with the provision of service to new customers but failed to include revenues generated by those same customers. The increased utility charges proposed by the Applicant are rejected by the Commission.

19. The Applicant has requested the recovery of \$1,500 in legal expenses associated with the participation of legal counsel in this proceeding. From a regulatory perspective VW is entitled to recovery of legal expenses associated with the conduct of this proceeding, however, these costs are not annual in nature and therefore, should be amortized over a reasonable period. The Commission finds it appropriate to amortize the \$1,500 legal expenses over a three year period. The Applicant's proposed expense increase should be reduced by \$1,000.

20. VW during 1990 incurred total maintenance expenses of \$2744. In this filing VW is proposing that the Commission recognize an expense of \$10,340 or an increase in repair and maintenance expense totaling \$7,596. In its post hearing brief the City argues for a significant reduction in the dollar amount of repair and maintenance expense increases to be included in rates.

But later in its brief the City presents complaints about the condition of existing facilities and service provision. The City indicates in its brief that they believe facilities are inadequately maintained, fire flow deficiencies exist on the system, poor general maintenance is occurring, unusable fire hydrants are on the system, leaking hydrants are not an unusual occurrence, etc. It appears from reading the City's brief that it would like the "best of all worlds" a well maintained water system at no expense to the subscribers.

21. VW in its late filed exhibits provide the Commission with a breakdown of its proposed repair and maintenance budget for the test period. As represented by the City the dollar amounts for the projects shown on this schedule are speculative but it is difficult, if not impossible, to conclude that a proposed maintenance budget of \$10,340 for a system costing approximately \$1.2 million in 1981 and providing minimal maintenance since commencing operation is unreasonable. The Commission supports adequate funding of repair and maintenance expenses because it enhances the utility's ability to provide reasonably adequate service and maintains the integrity of current facilities.

22. Recognizing that the proposed maintenance budget of VW is not documented to the degree that the Commission would like the Commission is going to impose on VW a reporting requirement for maintenance expenditures. VW will provide the Commission with a quarterly report detailing the following; maintenance project undertaken; the reason the project is necessary; name of the contractor; percent of project completed; copies of the billings from the contractor. If the maintenance is done by an employee of VW the same information as required previously will be provided the Commission only the detail will include wages paid and materials purchased instead of contractor name and contractor billings.

23. The Commission, based upon the preceding Findings of Fact, finds that the Applicant will incur operation and maintenance expenses totaling \$53,635.

24. The Commission further finds that the Applicant should be allowed to increase annual revenues by \$25,633. This requirement is calculated as follows:

Operating Revenues	\$28,002
LESS:	
Operating Expenses	<u>\$53,735</u>
Revenue Deficiency	\$25,733

#### RATE DESIGN

25. To generate the increased revenue determined appropriate in this order the Applicant proposes increasing rates and charges for all water services provided in the current rate structure and to implement an annual irrigation charge.

26. The Applicant in the proposed rate design has increased rates and charges applicable to residential customers by a greater percentage than that applied to commercial accounts. The Applicant in support of the proposed disparity in percentage increase between customer classes stated that the rate design proposal was an attempt to implement a rate, for the customer classes, comparable to that prevailing on the Clark Fork Water system and the Mountain Water system, both of Missoula. The Applicant's rationale for implementing disparate percentage increases between customer classes is not persuasive or supported by substantial evidence.

27. The Applicant's proposed rate design includes a new charge that would be assessed against consumers having a summer irrigation requirement. The Applicant is proposing that each customer having an irrigation requirement be assessed an annual charge based on the square footage of actual irrigated area. In determining the revenue contribution that would result from implementing this charge the Applicant did not ascertain the total square footage of irrigable area within its service territory. Instead of determining the actual irrigable area for each customer the Applicant assumed that all irrigation customers would pay the same annual flat fee for this service. The Applicant's failure to determine total area subject to the proposed charge and the exact total revenue that would be generated makes the proposal speculative and discredits the reasonableness of the proposal.

28. The Applicant did not present a fully allocated cost of service study in its application, and absent such a study, the Commission cannot determine the appropriate level of revenue contribution that should be recovered from each customer class. Without a cost of service study or substantial credible evidence supporting the reasonableness of the modifications to rate the structure,

as proposed by the Applicant, the Commission is unwilling to concur with the Applicant's proposed rate structure modifications.

29. Since the Commission cannot support the rate structure proposed by the Applicant it is incumbent on the Commission to provide an alternative proposal that will generate the increased revenues authorized herein. The Commission finds that without the cost of service study, the most reasonable and equitable method of generating the increased revenues is for the Applicant to increase all rates and charges by a uniform percentage.

#### MISCELLANEOUS

30. In 1981 the City of Missoula made a public policy decision regarding this utility operation. The City decided, for whatever reasons, that it was apparently in the public interest to lease the operation and maintenance responsibility of this publicly financed utility facility to the private sector. By entering into the lease the City created a hybrid utility operation, not a municipal utility and not a privately owned utility. Since the City leased the operating responsibility of this utility to a private entity the operation is subject to the full regulatory jurisdiction of this Commission. The City's creation of this hybrid utility operation presents an exceptional ratemaking problem for the Commission. The general philosophies applied in traditional ratemaking, for a municipally owned or privately owned utility, are not individually applicable to this hybrid. Therefore, to establish rates for VW the Commission must use ratemaking elements from both philosophies, in tandem, and contort these elements to fit VW.

31. In its brief the City presents objections to VW assessing the City a substantial fire hydrant rental charge. The City asserts that because VW has no investment in the utility plant associated with fire protection, which constitutes a substantial cost component in calculating a traditional hydrant fee, a greatly reduced assessment should be made against the City. The City further asserts that the "...City is unfairly and inequitably being required to substantially subsidize Valley West Water Company and its customers pursuant to the existing water rates..."

32. Although VW has no vested interest in the plant investment the subscribers connected to the water system do, because they as property owners are paying off the SID's. The City's proposal that the Commission limit or deny VW's fire hydrant rental fee would result in the Commission

having to increase the monthly charges imposed on all subscribers connected to the water system. Increasing the monthly rate to VW subscribers to recover fire protection costs would ignore the consumer investment in this plant and their entitlement to have the taxpayer base absorb costs for plant dedicated to fire protection.

33. During the hearing there were statements made by various witnesses indicating that VW was not being efficiently managed. The testimony indicated that VW has management problems in the following areas; failing to insure that all new customers subscribing to services are issued billings in a timely manner; failure to investigate alleged fire flow inadequacies; failure to timely repair utility facilities when reported; failing to comply with local ordinances regarding operation of the utility; having no local contact number on its monthly billings; etc.

34. It is clear from the record in this docket that the utility operators have failed to diligently discharge their management obligations. The Commission directs VW to be more responsive to the obligations imposed on it as a public utility. VW is to complete the following by June 10, 1991; conduct a complete inventory of connections to the water system to insure that billings being sent consumers are correct; repair the broken valves testified to during the public hearing; repair all leaking hydrants on the system; repair the two buried hydrants or in the alternative provide an explanation why repairs cannot be made; provide evidence that VW is in compliance with all city ordinances regarding operation of the system; investigate and ascertain whether fire flow at all hydrants is adequate; and on future customer billings show a local telephone contact number for consumers, as well as, the number of the Commission (it should be noted that the Commission number is provided for consumer complaints).

#### CONCLUSIONS OF LAW

1. The Applicant, Valley West Water Company, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over Applicant's rates and service pursuant to Section 69-3-102, 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

NOW, THEREFORE, IT IS ORDERED THAT:

1. Valley West Water Company is hereby granted authority to implement increased rates for its Missoula, Montana customers designed to generate additional annual revenues in the amount of \$25, 633. The increased revenue authorized herein is in lieu of, not in addition to, the revenue increase authorized in Order No. 5494.

2. Valley West is to file revised tariff schedules spreading the increased revenues as a uniform percentage increase to all services.

3. Valley West shall comply with the provisions outlined in Findings of Fact Nos. 22, 23, and 34.

DONE AND DATED at Helena, Montana this 14th day of March, 1991.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

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HOWARD L. ELLIS, Chairman

ATTEST:

Ann Peck  
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.

NOTE: This Proposed Order is a proposal for decision. Each party has the opportunity to file exceptions, present briefs, and have oral arguments before the PSC prior to Final Order. See, Section 2-4-621, MCA. Exceptions and briefs must be filed within 20 days of the service date of this Proposed Order. Briefs opposing exceptions must be filed within 10 days thereafter. Oral argument, if requested must be requested at or prior to the time of briefing. See, ARM 38.2.4803 and 38.2.4804.