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2011-051

August 19, 2011

Ms. Kate Whitney
Montana Public Service Commission
1701 Prospect Avenue
Helena, MT 59620

Re: Data Responses of Missoula Mayor John Engen

Dear Ms. Whitney:

Enclosed are the Public Service Commission (PSC) Data Responses of Missoula Mayor John Engen.

Additional copies have been provided to the Montana Consumer Counsel, the Clark Fork Coalition, representatives of the Carlyle Group, Park Water, and Mountain Water.

Respectfully yours,

CITY ATTORNEY'S OFFICE

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City Attorney

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AN EQUAL EMPLOYMENT OPPORTUNITY AFFIRMATIVE ACTION EMPLOYER M/F/V/H

Service Date: August 5, 2011

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

IN THE MATTER OF the Consolidated Petition by Mountain Water Company for Declaratory Rulings and Application for Approval of Sale and Transfer of Stock in Park Water Company	)))))	REGULATORY DIVISION DOCKET NO. D2011.1.8

MONTANA PUBLIC SERVICE COMMISSION DATA REQUESTS
PSC-028 THROUGH PSC-038 TO THE CITY OF MISSOULA

PSC-028

Regarding: Testimony
Witness: Engen

a. Has Mountain Water failed to provide access to clean safe drinking water other than the occasional upgrades and routine maintenance, etc., to the system? Please provide examples.
No, apart from a boil order due to a contaminated well in the early 1990s.

b. Why do you believe that the acquisition by the Carlyle Group would change the quality of service?
Because to date Carlyle Group has not owned and operated a water utility, I don't have any frame of reference to know whether the quality of service would change, nor did I state that in previous testimony. I do, however, believe that Carlyle's business model is based on generating the greatest rates of return on investment as quickly as possible, which can be achieved two ways: by cutting expenses and by increasing revenues. Unless Mountain Water is operated inefficiently today, cutting expenses certainly would change the quality of service. And raising rates, by the very nature of the action, changes the quality of service.

PSC-029

Regarding: Testimony
Witness: Engen

Does the City of Missoula have any experience in operating, owning, and maintaining a public water system?

Our experience with operating, owning and maintaining a public water system matches Carlyle's; the City of Missoula has none. We do, however, have a decades-long history of successfully managing a public wastewater system. In addition, we've worked closely in planning infrastructure improvements related to the water system and have inspected its installations. And a number of our employees have worked in municipal governments with public water systems. Municipal ownership of water systems is the norm in Montana; Missoula's circumstance is the exception.

PSC-030

Regarding: Testimony
Witness: Engen

Is the City of Missoula subject to the same standards of regulation as a private water utility? Please contrast the regulatory oversight of the Public Service Commission and the Montana Consumer Counsel to the regulatory oversight of the City of Missoula.

The City of Missoula, were it to acquire and operate the water utility, while not subject to PSC regulation, would continue to be regulated under state and federal laws. Rates would be subject to change based on the vote of the elected Missoula City Council, the legislative branch of the City of Missoula, a self-governing, chartered municipality of the State of Montana and the mayor if the City Council vote is a tie.

In addition to more general Montana and federal law regulating water rights, environmental protection, pollution and clean water, Montana state law pursuant to title 7, chapter 13, part 43 and title 69, chapter 7, MCA, entitled "Municipal Utilities," provides some significant regulatory controls with respect to the operation, management and administration of municipal utilities. Some examples include: (1) Subsection 7-13-4304(1) MCA, which requires a municipal governing body to take into account services provided and benefits received when establishing rates and charges for services; (2) Subsection 7-13-4304(1) MCA, which requires that water "rate, charges or rentals shall be as nearly as possible equitable in proportion to the services and benefits rendered"; (3) Section 7-13-4312 MCA, which provides that when a municipality provides its municipal utility services to properties located outside the city limits it must do so "at reasonable rates".

Also, title 69, chapter 7 MCA, entitled "Municipal Utilities," provides statutory requirements for municipal utilities, including: (1) Section 69-7-101 MCA, which requires that "Rates, charges, and classifications must be reasonable and just"; (2) Pursuant to section 69-7-111 MCA, a public hearing before the elected city council and mayor is required for any change of rates, charges or classifications and Montana municipal utilities are required prior to the public hearing to provide mail notice to all persons served by the municipal utility of the proposed changes to rates, changes or classifications. (Mountain Water does not have to specifically notify by mail each of the persons it serves and inform them about proposed changes to rates, charges or classifications.) (3) Pursuant to section 69-7-113 MCA, parties to a municipal utility rate hearing may appeal the municipality's decision to district court, and (4) Pursuant to

section 69-7-201 MCA, each municipal utility shall adopt, with the concurrence of the municipal governing body rules for the operation of the utility. The municipal utility rules must at a minimum contain those requirements of good practice which can be normally expected for the operation of a utility.

Finally, the Montana Consumer Counsel still may have an active role if Mountain water Company were owned by the City of Missoula. Pursuant to subsection 69-7-111(5) MCA, notice of all public hearings concerning Montana municipal utilities, including both water and/or sanitary sewer, the municipality is required to provide notice mailed with first-class postage to the Montana Consumer Counsel. With such notice, the Counsel may choose to play a role in any changes in municipal water utility rates, charges or classifications potentially imposed on any water customers.

PSC-031

Regarding: Testimony
Witness: Engen

a. Please explain the City of Missoula's approach to water loss mitigation if it owned Mountain Water. Mountain estimates approximately half of its water loss is due to service connections.
Our financial analysis suggests that significant overhead costs would no longer be paid under public ownership, which would provide the City additional resources to make incremental improvements to the system over time without necessarily raising rates, which the private utility is entitled to do under existing regulation. The City recognizes the need for system improvements for efficiency and for reasons of conservation and environmental stewardship. In our wastewater utility, we perform regular inspection and make repairs through the system as a matter of routine maintenance; we also invest capital as necessary for large-scale improvements. The City has invested more than $20 million in wastewater plant upgrades over the last decade, while maintaining rates that are among the lowest in the state.

b. Does the City of Missoula have in place or is the City proposing any incentives to homeowners to replace bad service connections? An example would be zero interest loans with repayments included in property taxes to allow for repayment with before tax dollars.
Those incentives aren't in place today, but are tools that would make a great deal of sense for the City to consider under public ownership. In addition, the City has talked about conservation incentives, including low-flow fixtures and toilets, and the basic conservation measure of full metering.

c. Is the City of Missoula prepared to provide any incentives to Mountain Water to assist in the replacement of outdated and leaking mains? An example would be a waiver of the pavement disturbing fee assessed for line repair. Why or why not?
The City of Missoula has a history of flexibility and cooperation within practical and regulatory constraints to assist in infrastructure improvements that benefit the public. The example cited, and others like it, would certainly bear consideration.

PSC-032

Regarding: Testimony Paragraph 12
Witness: Engen

Please provide the preliminary analysis that you referred to in Paragraph 12 in written and EXCEL format.

For illustrative purposes, we have assumed a purchase price of approximately $50 million. This is on the basis that Mountain Water represents approximately one third of Park Water whether measured by (1) the number of customers, (2) the company's earnings before interest, taxes, depreciation and amortization, or (3) the company's net plant, and the total purchase price (including debt) being paid by Carlyle for Park Water is $156 million. Our preliminary analysis suggests that a purchase price in this range could be supported without any increase in rates. The

City would be able to finance an acquisition 100% with municipal bonds, and would be able to finance future improvements to the system with tax-exempt debt, so its cost of capital should be lower than both Park Water's and Carlyle's, in addition to the fact that the City has the ability collect water connection fees for growth while Mountain Water's rate payer's have to reimburse the cost of private development main extensions. For illustrative purposes only, if one were to assume $6 million in net revenues for debt service, then the City would be able to support a purchase price of approximately $50 million while maintaining a credit rating in the "A" to Baa" category, without increasing rates above current levels.

PSC-033

Regarding: Testimony
Witness: Engen

Why did the City of Missoula not purchase Mountain Water originally from Montana Power? Was it afforded a "reasonable opportunity" to do so?

I don't have direct knowledge, but a recent Missoulian newspaper story offers this account:

The Montana Power Co. bought Missoula Light and Water in 1929. At the time, the utility controlled the city's electrical, central heating and trolley systems as well as the water supply.

City Attorney Jim Nugent was just getting settled into his post under Mayor Bill Cregg in 1979 when Montana Power announced it wanted to sell the Missoula water utility. Cregg wanted to buy it.

"He went to the City Council to inquire what they thought," Nugent said. "But before he got back to Montana Power, Montana Power had sold it to Sam Wheeler in California without notice."

Wheeler's Park Water Co. paid $7.5 million in 1979 for the Missoula system and a smaller one serving the town of Superior. It has been the parent company of Mountain Water Co. ever since.

PSC-034

Regarding: Ability to pay
Witness: Engen

The Carlyle Group is proposing to pay approximately $100 million for the Park Company that includes Mountain Water along with the outstanding debt obligations of Park. Mountain Water has about 1/3 of the customer base of Park Water. For the sake of questioning please assume a fair valuation for Mountain Water is approximately $53

million, and there is no gain on the sale. In a recent newspaper article you commented that the City of Missoula may consider of bid of $50 million for Mountain Water.

a. Please explain how the City of Missoula would purchase Mountain Water and not increase rates over Mountain's existing rates. Please support with cost analysis in electronic format with all formulas intact.
Simply put, a rough analysis that assumes a purchase price of $50 million suggests that existing rates provide sufficient cash flow to operate the company and service the associated revenue bonds of $50 million at current market rates. That statement is not meant to imply that the City of Missoula would never need to consider raising rates, but if we did, it would be for much different reasons (either expense or improvement driven) than a privately held utility. In addition, we believe that Mountain pays more than $1 million per year in overhead to Park Water. That overhead would be eliminated under municipal ownership.

b. Please explain how or whether the City of Missoula will replace the approximately $1 million lost property tax revenues that Mountain Water presently pays to the City, County and other affected parties. Will the City hold harmless all the affected parties? In other words, replace those lost revenues to the other government entities? Please provide all supporting analysis.
Mountain's current rate structure provides cash flow for operations, overhead and taxes. The City of Missoula would negotiate with appropriate taxing jurisdictions to ensure no jurisdiction endured undue hardship. It should be noted that municipalities are not required to provide payments in lieu of taxes and most simply do not as utility operators. All that said, I am keenly sensitive to the needs of taxing jurisdictions and would proceed to work with them in good faith.

c. If the response to hold harmless is yes, please provide all supporting documentation for your answer. If the response is no, have you notified the potential affected parties that they may be affected and to what extent? Why or why not?
Please see the answer to PSC-034 b.

d. Did the City approach Park Water to inquire about purchasing Park Water and its subsidiaries? Why or why not?
No. During a meeting with Mountain Water management when I was campaigning for my first term as mayor of the City of Missoula, management made it clear to me that Park's owner had no desire to sell to the City and, in fact, had created a number of barriers to ensure that successors in interest would not be able to sell to the City even if those successors were interested in doing so. Interestingly, Park or Mountain sold the Superior, Montana, system to the town of Superior, so it clearly recognizes municipal interest in ownership. As recently as August 10, 2011, Park and Mountain Water officials, when I asked them to tell me differently, did not disagree that Park was unwilling to sell to the City.

PSC-035

Regarding: Opportunity to purchase Mountain Water Co.

Witness: Engen

a. You said in paragraph #13 of your testimony that the City of Missoula should be afforded a "reasonable opportunity" to purchase Mountain Water Co. "at such time as the Carlyle Group decides to sell either Mountain Water Company or Park Water Company." Please explain what would constitute a "reasonable opportunity" from the City's perspective.
A chance to make a market-based offer to purchase the utility by a date certain before Carlyle were to entertain other offers.

b. Does the City oppose or support the proposed Carlyle-Park transaction?
Because all evidence suggests that there is no chance of municipal ownership under Park's watch and because there is a chance at municipal ownership under Carlyle's watch, the City supports the transaction.

c. If the proposed transaction is approved, does the City advocate that the PSC should condition the approval in some way(s)? Please specify the condition(s) sought by the City.
The City would appreciate the PSC's consideration of an agreement among the interveners in this docket that includes a variety of conditions to the approval of the transaction. That agreement is still in its formative stages, but will be available for public scrutiny and PSC review well in advance of the Commission's hearing on this docket.

PSC-036

Regarding: August 1997 Hiller-Kadas letter - ROFR
Witness: Engen

a. Montana Consumer Counsel witness Dr. Wilson questioned whether the right of first refusal (ROFR) extended to the City by Mountain Water in an August 1997 letter is operable under certain circumstances. Is the City relying on that letter as providing a ROFR in all circumstances? If not, in which circumstances would it and would it not apply?
The City's reliance on the operability of the letter has everything to do with Park's and Mountain's view of its operability. As recently at August 10, 2011, Mountain Water represented that if, and only if, Mountain Water were sold apart from Park Water would the letter be operative.

b. If there have been any updates to the August 14, 1997, letter or any other correspondence between Park/Mountain and/or Carlyle related to a City right of first refusal if Mountain Water Co. should be sold, please provide copies.
There are none of which I am aware.

PSC-037

Regarding: City of Missoula's interest in owning Mountain Water
Witness: Engen

a. At paragraph #8 of your testimony, you state the City "would provide more accountability." Please explain why you believe a publicly owned utility would be more accountable than a regulated privately-owned utility.
While executives and boards of private utilities have a responsibility to their customers through market and regulatory forces, they are ultimately accountable to shareholders who may or may not be customers and ratepayers and who may or may not care about anything but a return on their investment. Those shareholders interests may be in direct conflict with the interests of ratepayers, customers and communities, but shareholder interests are paramount to corporate executives and boards. Under public ownership of a utility, ratepayers who are electors have the right to vote, in effect, for the board of directors and executive (in Missoula's case, the city council and mayor), have open access to budgets, rate deliberation, long-term planning. Significant changes to operations, capital improvements and rates are subject to well-publicized public hearings and council votes. The operational motives of a publicly owned utility are simply and fundamentally different from a privately-owned utility. The motive to operate in the interest of returning profit on investment in the private model is replaced by the motive to operate a sustainable utility responsibly at the lowest practical cost to the ratepayers and, by extension, the community. Further, the Montana Constitution and state law provide for the public's right to records, to participation in public meetings and to observation of deliberations through public meeetings.

b. Please provide detailed information regarding the City's financial capacity to purchase and operate Mountain Water, how such a purchase would be financed, and the effect on rates.
Please see response to PSC-032.

c. Why should the PSC consider the City's interest in owing its own water utility during this proceeding, which is between Carlyle and Park/Mountain Water?
As the PSC continues to operate in the public interest, I would hope it would find the idea of municipal ownership of the water utility to be clearly in the public interest. We've demonstrated operational and financial capacity to own and operate the utility through materials provided as part of this docket and through our long-term operation of a utility. We've also illustrated, I hope, the clear advantages to a community of having its water utility owned by local ratepayers who are affected by operations every day instead of investors from around the globe who may have no idea where Missoula is on the map. In the long term, is the City of Missoula to control its water system, or do we leave remarkable responsibility to a string of unnamed and unknown investors who will succeed Carlyle?

d. Is the City in possession of any information that would lead it and the PSC to believe that Carlyle has any interest in selling Mountain Water to the City? If so, please provide it.
No. But Carlyle's business model to date clearly suggests that it buys assets, holds them for a relatively short term, and sells them at a profit. That suggests that Carlyle

will have an interest in selling Mountain Water. And there's no reason of which I'm aware for Carlyle not to consider the City of Missoula as a buyer.

e. Might it be possible and make more economic sense for the City to attempt to purchase the utility directly from Park Water or Mountain Water, instead of purchasing it from a subsequent buyer?
If Park or Mountain were willing sellers, yes. Again, that does not appear to be the case.

PSC-038

Regarding: Carlyle as purchaser
Witness: Engen

Explain why the City apparently believes it would be in the best interest of Missoula water customers for Park/Mountain Water to be sold to a multinational investment group like Carlyle that has no experience in operating a water utility.
Carlyle will continue to employ the good folks who have operated the utility in Missoula for many years as employees of Mountain. The City of Missoula would do the same. Operational expertise is in house today and will continue. I believe that the Carlyle purchase is a means to an end for Missoula water customers. The utility isn't for sale to the City of Missoula today under current ownership, but could be for sale to the City of Missoula tomorrow under Carlyle's ownership. If I could negotiate in good faith with Park and Mountain today to purchase the utility, I would jump at the chance. Unfortunately, I'm left to take a leap of faith based on my understanding of business models, an old letter and hope that this process gives Carlyle what it needs to consider a sale to the City of Missoula when the times is right. I hope that time is much sooner than later.