READING FILE.

Service Date: July 26, 1983

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

* * *

IN THE MATTER Of The Application Of The CITY OF DEER LODGE To Increase Rates And Charges For Water Service.	)))))	UTILITY DIVISION DOCKET NO. 83.2.13 ORDER NO. 5004

APPEARANCES

FOR THE APPLICANT:

M. K. "Kermit" Daniels, City Attorney, City Hall, Deer Lodge, Montana 59722.

FOR THE INTERVENORS:

None

FOR THE COMMISSION:

Eileen Shore, Chief Legal Counsel, 1227 - 11th Avenue, Helena, Montana 59620.

BEFORE:

John B. Driscoll, Commissioner and Hearing Examiner.

BACKGROUND

1. On February 28, 1983, the City of Deer Lodge (Applicant or City) filed an application with this Commission for authority to increase rates and charges for water service to its customers in the Deer Lodge, Montana area. The Applicant requested an average increase of approximately 165 percent, which would result in an annual revenue increase of approximately $130,600.

2. On May 25, 1983, pursuant to notice of public hearing, a hearing was held in the City Council Chambers, City Hall, Deer Lodge, Montana. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustment. At the close of the public hearing, the City waived its right to a proposed order and stipulated to authorize the Commission to issue a final order in this Docket. Section 2-4-622, MCA.

ANALYSIS AND FINDINGS OF FACT

General

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

Martin Olsen, Public Witness
Robert Powell, Public Witness
F. L. "Ted" Strebel, Public Witness
Barbara McOmber, City Clerk
James Gilbert, Fire Chief
Joe Dillon, Water Commissioner
Loy Mizner, Alderman
Malcolm McCallum, Alderman
John Wilson, Mayor
Tim Berry, Consulting Engineer
Harold Eagle, Consulting Engineer

These witnesses testified relative to: the need for proposed capital improvements, the estimated cost of proposed capital improvements, the financing of the proposed capital improvements, the financial condition of the water utility, service problems experienced by consumers and rate structure.

4. No public testimony was presented at the public hearing in opposition to any issue under consideration by the Commission in this Docket.

Proposed Capital Improvements

5. The City in its application has proposed a capital improvement program which includes the construction of a cross-town connector, the replacement of existing 6 inch water line on Maryland Avenue, Bielenberg and St. Mary, with 10 inch water line and the construction of a 2 million gallon reservoir. The City proposes the capital improvement program be funded from a revenue bond issue having a term of 20 years and a maximum interest rate of 11 percent, with the requirements that the City have a reserve fund in an amount equal to the maximum principal and interest payment on the bonds and provide a debt service coverage of 125 percent.

6. The City proposes in its capital improvement program the construction of a cross-town connector on the South side of the City. This cross-town connector will connect the City's two major service areas, which lie east and west of the Clark Fork River, with the major portion of the service area being located west of the river.

The City's consulting engineers indicated that at the present time there was a poor transfer of water between the east and west service areas during periods of high demand, resulting in decreased water pressure. Continuing, the engineers stated that construction of a cross-town connector would alleviate pressure problems experienced by consumers in the South and Central parts of

the City during periods of high demand.

7. The City's proposed capital improvement program includes the replacement of an existing 6 inch water main on Maryland Avenue, Bielenberg and St. Mary with 10 inch water main. The testimony of City officials and the consulting engineers indicated that the 6 inch distribution mains in this area were inadequate, given the volume of water required to serve this area.

Located in the area where the main replacement is proposed, is the hospital, rest home and medical clinic, each of which are high volume users. Exhibit No. 5, which is a letter from Powell County Community Hospital to the City of Deer Lodge, reveals that the hospital is experiencing pressure problems resulting in an inadequate supply for daily hospital operation. The letter states ". . . the problem is more noticeable during summer months, but the problem is there throughout the year." This indicates that a health and sanitation problem could occur if the pressure problem in the area were allowed to continue.

James Gilbert, Fire Chief, City of Deer Lodge, testified that he had grave concerns relative to the ability of the fire department to control a fire in the area where the proposed main replacement is contemplated, given the inadequate pressure currently existing. He further stated it was his opinion that this condition constitutes a serious and immediate threat to the patients, occupants and employees of the hospital, rest home and medical clinic.

8. The capital improvement program outlined by the City includes the construction of a 2 million gallon reservoir to enhance the City's ability to store water. At the present time the City has the ability to store 660,000 gallons of water in the one reservoir connected to the system.

An analysis was conducted by the City's consulting engineers to determine the amount of storage that would be advisable for the City of Deer Lodge to meet peak demands, emergency conditions and fire flow requirements. This analysis indicated the City should have storage capability of 2,700,000 gallons in order to insure adequate supplies of water would be available to meet operational contingencies that may be placed on the water system.

9. The three public witnesses testifying on behalf of the City, each of whom are subscribers to the utility service and located in different areas of the City, testified they were experiencing problems with low water pressure. Their testimony indicated that the pressure problem was more acute during the irrigation months but there were occasions during non-irrigation months when pressure problems did occur.

One of the public witnesses, Ted Strebel, a retired civil engineer whose residence is located in the central part of the City, testified that he had been totally without water on three different occasions during the summer of 1982. He stated that it was his opinion the distribution system was improperly constructed and this was the cause of the pressure problems being experienced by consumers.

10. The Commission, having considered the testimony of the City that pressure problems are being experienced by consumers of the water utility service, the indication that fire flows within the City are inadequate and presenting a threat to the safety of patients, occupants and employees of the hospital, rest home and medical clinic, the analysis of the consulting engineers reflecting inadequate water storage capability and the corroborating testimony of the public witnesses, finds that it is prudent for the City to construct the proposed capital improvements to correct deficiencies.

The Commission also finds the City's estimated cost of $753,000 for construction of the proposed capital improvements is a reasonable estimate.

Debt Service

11. The City proposes to finance the construction costs of the capital improvement program by issuance of revenue bonds.

The City proposes to issue $753,000 in revenue bonds to be repaid over a period of 20 years at a maximum interest rate of 11 percent, with the requirements that the City have a bond reserve fund in an amount equal to the maximum principal and interest payment on the bonds and provide a debt service coverage of 125 percent.

12. The proposed $753,000 revenue bond issue with an interest rate of 11 percent will have an annual principal and interest payment of $94,500. This item of expense was not contested by any party in this proceeding, and is, therefore, ac-

cepted by the Commission.

13. With the issuance of the revenue bonds the City will be required to have a net operating income of at least $23,625 to meet the 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 the bond issue by 25 percent ($94,500 x .25 = $23,625).

14. With the issuance of the revenue bond, the City will incur an obligation to establish a reserve fund, called the "Revenue Bond Account", in an amount equal to the maximum principal and interest payment on the bond issue. The bond issue will be structured such that the reserve fund will be built up over a five year period rather than capitalizing the reserve fund from the bond proceeds. The amount of the required reserve fund will approximate $94,500 and will be funded from the unencumbered revenues generated by the 125 percent coverage ratio.

For the City to accumulate the required $94,500 in the "Revenue Bond Account", during the five year period, it will have to use an average of $18,900 of the proceeds generated by the bond coverage on an annual basis. This will result in the City having approximately $4,725 annually, available from coverage ratio monies, to make capital improvements to the water system and meet unforseen operating costs.

15. The Commission finds the bonding requirements, establish-

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

16. The Commission finds the issuance of $753,000 in revenue bonds with a term of 20 years and a maximum interest rate of 11 percent, with the requirement that the City establish a bond reserve in an amount equal to the maximum principal and interest payment on the bonds and provide a debt service coverage of 125 percent, is appropriate.

Operation And Maintenance Expense

17. The test year in this case is the fiscal year ending June 30, 1982, adjusted for inflation. The Applicant presented the following test year operation and maintenance expenses:

Pumping, Maintenance, Power	$35,500
Distribution System Maintenance	$20,000
Purification	$ 900
Customer Accounting	$22,000
Depreciation-Replacement	$15,100
Total Operation and Maintenance Expense	$93,500

18. The only item of expense the Commission finds questionable is the $15,100 for "Depreciation-Replacement". The Applicant's witnesses during the course of their testimony could not specify for what purpose these funds would be used.

Relative to funding "depreciation", it is not the Commission's general policy to allow municipal utilities to fund a "depreciation" account because it is the usual and recommended practice of municipal utilities to fund capital improvements through revenue bonds, which are repaid over the useful life of

the improvement. If the Commission were to allow municipal utilities to fund a "depreciation" account, given the widespread use of revenue bonds, the Commission would be allowing the utility to charge the current rate payer twice for the same asset or capital improvement. Therefore, the Commission rejects the Applicants request to fund a "depreciation" account.

The Commission's general policy is to allow for funding of a "replacement" account (recurring annual capital improvements) to insure that existing utility facilities are adequately maintained. As a pre-condition to granting this type of funding, the Commission requires that the utility submit a schedule for a 3 to 5 year improvement program. The Applicant in this case has failed to submit such a schedule and was unable, at the hearing, to specify for what purpose these funds would be used. The Commission finds it would be bad regulatory policy to grant funding for unspecified improvments.

19. The Commission finds the appropriate level of operation and maintenance expense of the utility to be $78,400 ($93,500 - $15,100 = $78,400).

20. Based upon the preceding findings of fact the Commission finds the following test year expenses to be reasonable:

Operating Expense	$78,400
Debt Service	$94,500
Debt Service Coverage	$23,625
Total Expense	$196,525

The test year expense assumes full annualized costs for the pro-

posed revenue bond issue. The Commission chooses to calculate expenses in this manner, as it is the most reasonable way of accounting for the effect of the proposed bond issue on the operating statement of the utility.

Revenue Need

21. The Applicant in the application indicated that under the present rates, annual revenue generation would be approximately $88,680. The Applicant also indicated in its application that if the rates as proposed were granted the annual revenues of the utility would increase to $211,500.

22. At the hearing the City's consulting engineer was cross-examined on the disparity between the revenue contribution of commercial flat rate consumers versus metered commercial consumers. The City's exhibits indicated that the commercial metered consumer was contributing approximately 3 times the amount of revenue as the commercial flat rate consumer, who was assumed to have the same average annual water consumption as the metered commercial user.

The City's consulting engineer was unable to respond or explain why this disparity in revenue contribution existed. Therefore, the Commission required that the Applicant submit a late-filed exhibit evaluating the disparity and explaining the reason for its existence.

23. On June 15, 1983, the Commission received the requested late filed exhibit explaining the reason for the disparity between the revenue contribution of commercial flat rate consumers versus metered commercial consumers.

The City's consulting engineer, during the course of preparing the late filed exhibit, discovered he had over-stated metered commercial water sales through his failure to convert annual water consumption for two meter sizes to a monthly use figure. The engineer's failure to make this conversion results in an over-statement of the revenues that will be generated from sales of water to commercial metered users.

After correcting for the consumption error, the revenue contribution of the commercial metered consumer versus the commercial flat rate consumer closely approximate each other. The Commission is now satisfied that the commercial metered consumer is not being required to contribute an unfair amount of the revenue requirement.

24. The engineer's error also results in an over-statement of the total annual revenues of the water utility at both the present and proposed rate levels. After correcting for the error the Commission finds that the total revenue generation under the present rates is $79,680 and that total water utility revenues under the proposed rates will be $171,970.

25. The Commission, based upon Findings of Fact Nos. 20 and 24 finds that the Applicant should be allowed to increase revenues by $116,845 annually after completion of the proposed revenue bond sale. This requirement is calculated as follows:

Operating Revenue	$79,680
Operating Expense	$78,400
Debt Service	$94,500
Debt Service Coverage	$23,625
Total Revenue Requirement	$196,525
Revenue Deficiency	$116,845

26. The Applicant being aware that the consulting engineer's error will result in reduced revenues, with implementation of the rates as contained in the application, has made a conscious decision not to request modification of the rates. This decision has the effect of limiting the revenue increase authorized in this order to $92,290. Calculated as follows:

Revenue - Proposed Rates	$171,970
Revenue - Present Rates	$ 79,680
Difference	$ 92,290

Rate Structure

27. The Applicant's proposed rate structure includes a minimum charge and three declining rate blocks for metered residential customers. Calculation of the applicable rate for residential flat rate consumers, commercial metered consumers and commercial flat rate consumers is accomplished by application of a 130%, 120% and 150% surcharge to the metered residential rate, respectively.

28. The Applicant proposes the following declining rate blocks and consumption charges for metered residential consumers:

8 to 50 ccf	$0.65 per/ccf
51 to 200 ccf	$0.55 per/ccf
Over 200 ccf	$0.45 per/ccf

Examination of the consumption data submitted by the Applicant indicates none of the metered consumers connected to the water system have consumption in excess of 200 ccf on a monthly basis.

Declining block rates are in conflict with efficient resource management and provide an incentive to increase consumption into lower priced tail blocks. To provide an incentive to increase con-

sumption results in an inefficient allocation of the natural resource and often results in it becoming necessary to increase plant capacity, which in turn results in higher rates to the consumer.

Since none of the consumers presently connected to the system have monthly consumption in excess of 200 ccf, the Commission finds that the Applicant should delete the proposed over 200 ccf tail block. Deletion of this rate block will accomplish more efficient management of the natural resource and discourage consumption in excess of necessity. Also when and if the City finds it necessary to expand plant, given current economic conditions, it may find it advisable to implement an inverted block rate structure in an effort to recover costs of plant additions from those consumers receiving the benefit. Deletion of the last tail block will lessen customer impact if an inverted block is implemented.

29. Relative to the Applicant's proposal to use a surcharge system for determining the applicable rates for consumers, other than residential metered, the Commission finds that for purposes of clarity the Applicant should submit separate rate schedules reflecting the specific rate for each customer classification.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and subject matter in this proceeding. Section 69-3-102, MCA.

2. The Commission afforded all parties interested in this proceeding proper notice and an opportunity to participate. Sec-

tion 69-3-303, MCA.

3. The rates approved herein are reasonable, just and proper. Section 69-3-201, MCA.

ORDER

THEREFORE, THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. The City of Deer Lodge shall file tariffs, consistent with the Findings of Fact herein, generating an annual revenue increase of $92,290.

2. The rates approved herein shall not become effective until the first day of the first month following the sale of the revenue bonds.

3. The City of Deer Lodge shall notify the Commission of the date the bond sale is completed.

4. A full, true and correct copy of this order shall be sent forthwith by first class United States mail to the Applicant and all other appearances herein.

DONE IN OPEN SESSION at Helena, Montana this 18th day of July, 1983 by a 5-0 vote.

DOCKET NO. 83.2.13, ORDER NO. 5004

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

Thomas J. Schneider, Chairman

John B. Driscoll, Commissioner

Howard L. Ellis, Commissioner

Clyde Jarvis, Commissioner

Danny Oberg, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary

(SEAL)

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