

## Division Recommendation

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## **Background of Mountain Sewer**

Mountain Sewer Corporation (Mountain Sewer or the Company) is a privately-owned public utility that provides sanitary sewer service to residential and other customers near Huntsville, Weber County, Utah. The Company's principal place of business is located at 5393 E 3850 N, Eden, UT 84310. Mountain Sewer was organized April 27, 1984 and is an active company in good standing with the Division of Corporations.

Mountain Sewer has been regulated by the Commission since it began providing sewer service. On June 11, 1985, the Commission issued a Report and Order granting a Certificate of Public Convenience and Necessity (CPCN), No. 2163, to Mountain Sewer. On October 8, 1991, the Commission granted Mountain Sewer's petition to expand its service area, granting a CPCN to the Company to provide sewer service in the expanded service area.

Mountain Sewer's initial tariff was issued on October 9, 1986, with an effective date of October 15, 1986. Its last revised rate and fee schedule was issued and became effective November 1, 1987. The rates and fees have not changed since this date.

From its inception in 1985 until July 2011, Dr. Ronald J. Catanzaro owned 100% of the issued and outstanding stock in Mountain Sewer. In July, 2011, Dr. Catanzaro transferred all of his ownership interest in Mountain Sewer to Valley Utility Company, LLC (Valley Utility) and Mountain Sewer continues to operate under the Mountain Sewer name.

Mountain Sewer currently serves 129 active connections and anticipates adding one more connection before the end of 2012, making the total active connections 130. Mountain Sewer also has 55 standby connections, but anticipates having 64 standby connections by the end of 2012. The Division calculated the rates and fees based on 130 active connections and 64 standby connections.

### **Financial Background of Mountain Sewer**

Mountain Sewer's rates and fees have remained the same since its inception. The developer, Dr. Ron Catanzaro, set the rates and fees lower than was needed to cover the costs of running the sewer company. It is typical for developers to subsidize utility rates and fees in order to keep rates low to attract prospective buyers. Since Mountain Sewer's inception, Dr. Catanzaro has subsidized it, conservatively, for over \$1,000,000 (Exhibits 1.5, 1.6 and 1.7). In the past several years, Dr. Catanzaro was no longer able to subsidize the sewer company, to the extent that he had in the past.

### **There are three open Mountain Sewer dockets before the Commission:**

- I. Docket No. 11-097-01, Formal Complaint and Supplemental Complaint
- II. Docket No. 11-097-02, Notice of Intent to Sell Mountain Sewer and Lakeview Water
- III. Docket No. 11-097-03, General Rate Case and Special Assessment for Mountain Sewer

The Division will address each docket separately. The parties have had extensive discussions and have conducted discovery pertaining to the three dockets.

## **I. Docket No. 11-097-01, Formal Complaint and Supplemental Complaint**

An informal complaint was filed against Mountain Sewer on or about February 17, 2011.

Subsequently, a Formal Complaint and Supplemental Complaint (May 26, 2011) were also filed.

The complaints consist of Financial Irregularities and Operational Deficiencies.

### **A. Financial Irregularities**

Mr. Frank Cumberland, a customer of Mountain Sewer, and an intervenor in this case, filed a supplemental complaint, received by the Commission on May 26, 2011.

Part two of the supplemental complaint, titled “Financial Irregularities,” alleges numerous improprieties by Mountain Sewer in regards to its financial transactions and record keeping.

The Supplemental complaint first addresses billing irregularities regarding connection fees, standby fees and unbilled monthly sewer fees. Mr. Cumberland has provided several invoices and contracts that appear to show Dr. Catanzaro waiving connection fees, past-due rate amounts and over-charging or under-charging for connection fees. The Division has reviewed these invoices and agrees with Mr. Cumberland that it appears as though Dr. Catanzaro, on more than one occasion, charged fees and rates that were different than those on Mountain Sewer’s tariff as approved by the Commission. The Division has encouraged Mountain Sewer to refund over-billed amounts that fall within the statute of limitations as Mountain Sewer is made aware of them. The Division has also encouraged customers who may have been overbilled to seek

repayment from Mountain Sewer. Most of the discrepancies cited by Mr. Cumberland are well past the statute of limitations. Given the Division's dealings with Mountain Sewer's new ownership and management, the Division is confident that Mountain Sewer will charge only the amounts allowed in its tariff.

In Exhibit C, Part Two of the Supplemental Complaint, Mr. Cumberland also alleges,

*"... possible comingling of funds between and among Mountain Sewer Corp., Lakeview Water Corp., and Mr. Catanzaro's other corporations, including his personal finances."*

Based on the aforementioned billing irregularities, and the speculation of comingling of funds, in Exhibit C, Part Two of the Supplemental Complaint, Mr. Cumberland alleges that there is

*"quite possibly fraud on the part of Mountain Sewer ..."*

Mr. Cumberland also speculates that many of the fees collected by Mountain Sewer were not properly deposited into Mountain Sewer's account, which negatively impacts the operational funds available to Mountain Sewer.

Conversely, Dr. Catanzaro and his representatives have repeatedly stated that Dr. Catanzaro has been subsidizing Mountain Sewer, from his personal funds, for years. Page 3 of the General Rate Case states,

*"... Mountain Sewer was heavily subsidized by Dr. Ronald Catanzaro. Mountain Sewer has also taken out private loans to meet expenses and continue providing sewer service to its customers."*

The Division wishes to make it clear that although Mountain Sewer's General Rate Case states that Dr. Catanzaro subsidized and allegedly loaned funds to Mountain Sewer, the Company is not seeking to be reimbursed for Dr. Catanzaro's subsidies or the private loans in the General Rate Case or the Special Assessment.

Typically, in cases of alleged fraud and comingling of funds, a careful and thorough audit of the books and records by Division auditors/investigators can either confirm or refute such allegations. In this case, because the books and records are not available for review, either because they were never kept or they are no longer available, the Division has recreated, based on the best available information and to the best of its ability, a detailed analysis showing the potential revenues and estimated expenses of Mountain Sewer since 1984 through 2010. The amounts authorized in the original rate case were used for 2011 and included to assist in determining the amounts for 2010 and prior periods.

This detailed analysis seeks to determine if revenues, in excess of expenses, were available to benefit Dr. Catanzaro, or his other corporations.

The detailed analysis was performed as follows:

**1. Number of Mountain Sewer Connections, Exhibit 1.1**

The Division requested Mountain Sewer to provide a detailed and verifiable accounting of all Mountain Sewer Connections. Mountain Sewer provided print-outs for each lot titled "Ownership and Current References" that it obtained from Weber County's

Property Information Systems. The Division verified the accuracy by randomly matching lots within the service area to one or more of the following references: Parcel #, Township/Range/Section, Lot number, Address, Owner's Name and Year Built. To ensure that each lot's rates are accounted for and to err on the conservative side, each connection was assumed to have been connected and paying rates to the sewer company for the entire year, regardless of when the actual connection would have been made during the year. See Exhibit 1.1.

**2. Projected Revenues and Estimated Expenses, Exhibit 1.2**

The Division asked Mountain Sewer to prepare a detailed spreadsheet showing Mountain Sewer's best estimate of revenues and expenses for the period of 1984 to 2010. The estimated potential revenue was calculated by applying the \$22 monthly sewer fee by the number of connections per Exhibit 1.1. The expenses were estimated by applying the Consumer Price Index (CPI) to 2010's known and verifiable amounts and projecting them back to 1984. See Exhibit 1.2 for details.

**3. Summary of Expenses from Mountain Sewer's Annual Reports (2000 – 2010), Exhibit 1.3**

The Division then prepared a summary of the expenses listed on the available Mountain Sewer Annual Reports from 1999 to 2010. See Exhibit 1.3 for further details.

**4. Applicable Estimated Expense Adjustments of Mountain Sewer, Exhibit 1.4**

The Division applied the expense amounts per the annual reports, when appropriate, to refine the expense amounts listed in Exhibit 1.2. See Exhibit 1.4 for additional details.

**5. Projected Revenues (Not Including Connection Fees) VS Estimated Expenses,**

**Exhibit 1.5**

The corrections, additions and adjustments to expenses on Exhibit 1.4 were applied and brought forward to Exhibit 1.5. This schedule uses the monthly sewer rates as the sole source of revenues and then compares these revenues to the estimated/projected expenses. Exhibit 1.5 shows that during the period from 1984 to 2010, Mountain Sewer has operated at an estimated loss of over \$1.4 million. To assist in the understanding of this analysis, it is also presented graphically as part of Exhibit 1.5.

**6. Projected Revenues (Including Connection Fees) VS Estimated Expenses, Exhibit**

**1.6**

The corrections, additions and adjustments to expenses on Schedule 1.4 were applied and brought forward to Exhibit 1.6. This schedule uses the monthly sewer rates plus the connection fees of \$3,000 per connection, as potential sources of revenue and then compares these revenues to the estimated/projected expenses. Exhibit 1.6 shows that during the period from 1984 to 2010, Mountain Sewer has operated at an estimated loss of over \$1 million. To assist in the understanding of this analysis, it is also presented graphically as part of Exhibit 1.6.



The Division acknowledges that the estimated income and estimated/projected expenses are just that, estimates. Additional analysis could be done to further refine the amounts. However, based on the large dollar amount of expenses compared to revenues, further analysis is deemed unnecessary.

The intervenors also speculated that funds from Mountain Sewer's sister company, Lakeview Water, were improperly used to subsidize Mountain Sewer, and also potentially vice versa. Some of the intervenors also feel that an audit of Lakeview Water is necessary to determine to what extent, if any, its funds were improperly diverted from Lakeview Water to be used for the operations of Mountain Sewer.

The Division reviewed the prior audit of Lakeview Water performed by Division auditors in 2007. This audit was done in connection with a rate increase case for Lakeview Water, Docket No. 06-540-T01. The auditors indicated in the Division's Memo to the Utah Public Service Commission on August 6, 2007, page 4, Docket number 06-540-T01,

*"The Division analysis shows the proposed rates to be just and reasonable. **Even with the proposed rate increase, LWC appears to be under-earning.** The overall effect of this rate change is that it will bring much needed revenue to LWC, **which appears to have been subsidized by the developer for a number of years.**"*

*[Emphasis added].*

Based on the statement above, even charging the rates authorized in the rate case, Lakeview Water was and is still under-earning. This means that Lakeview Water must have been

subsidized, was still being subsidized, although not from Mountain Sewer, because Mountain Sewer operated at losses during the period from 2007 to the present and thus had no revenues to contribute to Lakeview Water. Additionally, the Division's previous auditors indicated, that prior to the Lakeview Water rate case, it appears as though the developer, Dr. Catanzaro, had been subsidizing Lakeview Water. Once again, funding for Lakeview Water could not have come from Mountain Sewer because Mountain Sewer was operating at a loss for that time period. Additionally, based on the aforementioned financial analysis, Mountain Sewer was being subsidized as well, although not by Lakeview Water, since Lakeview Water operated at a loss, requiring subsidization itself. The Division does not find any evidence that Mountain Sewer was being improperly subsidized by funds from Lakeview Water or vice versa. The Division concludes that neither Mountain Sewer, nor Lakeview Water's operations generated revenues in excess of expenses and; therefore, funds were not available for Dr. Catanzaro's personal use or to subsidize the other company. Further, the Division concludes that it was Dr. Catanzaro, not Lakeview Water who subsidized Mountain Sewer, during the period of 1984 through 2011, likely in excess of \$1 million.

## **B. Operational Deficiencies**

When Dr. Catanzaro could no longer afford to subsidize the sewer company to the extent he had before, maintenance of the system suffered, which apparently precipitated the complaints by several of the ratepayers, starting in early 2011.

Some of the chief complaints are:

1. Equipment is in ill repair.
2. System in designed improperly.
3. System is maintained improperly.
4. System is constructed improperly.
5. Customers feel the sewer lines should be inspected by camera annually.
6. The access road to Mountain Sewer ponds is not maintained, and is impassable in spring.
7. Physically pumping raw sewage from holding tanks and lift station and the transportation of raw sewage over local streets onto private property and dumping raw sewage into manholes in streets on private property.
8. The access road to Mountain Sewer ponds is not maintained, and is impassable in spring.
9. Storm water intrusion in the sewer system.
10. Possible raw sewage contaminating Pineview Reservoir
11. Rags, clothes and other trash put into sewer system by customers causing blockage in pipes, pumps and grinders.

Starting in July 2011 when Valley Utility took over ownership and operations of Mountain Sewer, Valley Utility made several urgently required repairs to the sewer system to primarily address the issues brought forth in the complaint. Specifically, the major repairs and maintenance includes:

- Installing cleanouts.

- Camera inspection of sewer lines.
- Repairing sewer lines.
- Construction to repair and improve the access road to Mountain Sewer's ponds. A new manhole was also added on Mountain Sewer property, near the sewer ponds, to facilitate dumping of sewage in emergency situations.
- Grading and site improvements.
- Repair and improve manholes to eliminate storm water intrusion into the sewer system.
- Repair and improve other infrastructure to eliminate water and other debris from entering into the sewer system.
- Replace the discharge flanges in the sump (pump).

The aforementioned urgent repairs were needed to make the sewer system as reliable as possible at a cost of \$63,361.05. These costs were requested to be recouped in a special assessment.

However, the Division believes they should be disallowed in the Special Assessment, but should be included in the ratebase.

Since these repairs, the Division is unaware of any additional complaints regarding system operations.

To assess the operations of Mountain's Sewer's system the Division contracted with an independent engineer, James Ormsbee, P.E., President of Elkridge Engineering, LLC. Mr.

Ormsbee has reviewed and assessed the urgent repairs described above to ensure that the repairs were prudent and necessary and completed at a reasonable price. The engineering report is attached as Exhibit 2.

## **II. Docket No. 11-097-02, Notice of Intent to Sell Mountain Sewer and Lakeview Water**

On August 18, 2011, Dr. Catanzaro filed notice of ownership transfer with the Commission. The notice stated that Mountain Sewer and Lakeview Water hereby notify the Public Service Commission that Ronald J. Catanzaro has transferred all of his ownership interest in Mountain Sewer and Lakeview Water to Valley Utility. The notice represented that “By this ownership transfer, no assets owned by Mountain Sewer or Lakeview Water were sold or transferred to Valley Utility or any other entity. Mountain Sewer and Lakeview Water have retained ownership of all assets, equipment, and infrastructure and continue to operate and provide utility service to their customers.” Finally, the notice stated, “In addition, Valley Utility is not a public utility regulated by the Commission, and does not itself provide any utility service.” Based upon the representations in this notice and other information provided to the Division, it is the Division’s understanding that the transfer technically was consummated by the sale and purchase of 100% of Mountain Sewer’s stock, not the sale and purchase of assets.

At the time Mountain Sewer was granted a certificate of public convenience and necessity (1985 Order), all of the outstanding shares of Mountain Sewer were owned by Dr. Ronald J. Catanzaro,

or other corporations where Dr. Catanzaro owned all the shares. The cost of the system was funded in part by a \$457,000 loaned “by the sole shareholder of the corporation,” repayable pursuant to a promissory note secured by a trust deed and a security interest in real property, personal property, and equipment owned by Mountain Sewer. The 1985 Order stated:

*In the event Ronald J. Catanzaro, the sole shareholder of the Applicant, should desire to sell or assign the note due to him from the Applicant or any controlling interest in the Applicant, he shall first give thirty (30) days written notice of such intent to the Division of Public Utilities. In the event the Division of Public Utilities should petition this Commission prior to the expiration of said thirty (30) days, this Commission shall conduct a hearing for the purpose of determine whether to approve such a sale, conditionally approve such sale, or disapprove such sale.*

Upon receipt of the August 18, 2011, notice of ownership transfer, the Division did not request a hearing to “approve, approve with conditions or disapprove an anticipated change of ownership” within 30 days after the filing of the August 18, 2011 notice of intent to sell.

On July 21, 2012, Mountain Sewer has satisfied its obligation, including interest, to Valley Utility and/or Ray Bowden through a private agreement and, therefore, it appears that Mountain Sewer no longer is liable for this loan nor any interest that may have been due.

With the original \$457,000 loan, plus interest, satisfied, the Division believes that the transfer of ownership is in the public interest and recommends that the Commission approve the transfer.

### **III (a). Docket No. 11-097-03, General Rate Case for Mountain Sewer**

On April 6, 2012, Mountain Sewer filed a request for a General Rate Increase; Docket No. 11-097-03. At that time, Mountain Sewer was seeking a monthly fee for active connected customers of \$57.06 and System Fees (Standby Fees) of \$24.40. As more data was obtained by Mountain Sewer, it adjusted the rates. Mountain Sewer filed an updated Exhibit G in its Pre-filed Testimony of July 26, 2012. This requested rates of \$73.75 for active connected customers and \$47.57 for its standby customers. Reasons for the increase in the requested rates included additional legal fees spent by Mountain Sewer for the dockets before the Commission and the addition of fees it was required to pay its State Certified Operator.

#### **Test Year**

The test year is 2012. Actual figures are available through June 2012, with the remainder of the year projected as to expenses and revenues generated by standby customers and connected customers. Additionally, amounts from the end of 2011 are also used as needed in determining average costs. Legal fees incurred in the open dockets related to Mountain Sewer are amortized over five years to offset the large dollar amount if taken all at once.

#### **Explanation and Comments Regarding the Information Used in the Rate Analysis, Exhibits 3.1 through 3.9.**

The Division does not typically go into this depth and level of explanation of its exhibits and recommendation, but are doing so in this case to assist the intervenors and other concerned

parties involved in their understanding of the process used by the Division in arriving at the rates to be recommended to the Public Service Commission. Specific line items on each exhibit that the Division believes needs an explanation are explained in the footnote section of each exhibit.

### **Summary of Workpaper Exhibits, Exhibit 3.1**

This exhibit displays only selected amounts from selected exhibits. The recommended rates are highlighted in yellow and the recommended one-time payment Special Assessment is highlighted in green. Please see the referenced exhibit for complete details.

### **Income Statement Analysis, Exhibit 3.2**

The Division has reviewed the expenses submitted by Mountain Sewer and listed them on Exhibit 3.2 of the rate analysis. Column A of this schedule shows the expense amounts originally included on Mountain Sewer's rate increase request of April, 6, 2012. Column B shows the expense amounts included in Mountain Sewer's updated Exhibit G of its pre-file testimony of July 26, 2012. The Division's recommended adjustments are listed in Column C and its revised amounts are shown here in Column D. The Division arrived at its recommended expense amounts after a thorough and exhaustive review of Mountain Sewer's submitted documentation as well as its projections.



Based on the recommendation of the Engineering Report, the Division also added \$500 to line 14 to be used to hire an independent and qualified engineer to inspect and assess the overall health of the sewer system on an annual basis. The Division also made an adjustment to the legal fees. Please refer to Exhibit 3.2 for complete details.

### **Depreciation Expense and Accumulated Depreciation Reconciliation, Exhibit 3.2a**

Exhibit 3.3a captures the total Utility Plant in Service account, from which depreciation expense and accumulated depreciation are calculated. The Division used 1984 as the beginning year and reconstructed the Utility Plant in Service using numbers from Mountain Sewer's original CPCN and its 2010 Federal Depreciation Schedule, see Exhibit 3.2c. Additions to the Utility Plant in Service from 1984 through 2010 are also based on Exhibit 3.2c. The Division used actual and projected numbers for 2011 and 2012.

Significant additions or deletions from the amounts on Mountain Sewer's depreciation schedule used for tax purposes to this exhibit are:

- The Division included the infrastructure additions represented by the \$3,000 connection fees for each connection through 2012. This resulted in a \$390,000 addition to infrastructure.

- According to the Engineering Report, Exhibit 2, the fourth holding pond is currently not being used and is in disrepair. Additionally, the capacity of the sewer system without the fourth storage pond is adequate to accommodate the existing connections, the 100 connections allocated to the county and the additional 120 proposed connections. Therefore, the fourth storage pond is not used and useful, nor is it expected to become so in the near future, and is omitted from the Utility Plant in Service account along with its corresponding depreciation expense. Likewise, the adjustment was also made to Exhibit 3.2b to remove it from the Contribution in Aid of Construction account along with its amortization.

### **Contribution in Aid of Construction (CIAC) and the Accumulated Amortization of CIAC**

#### **Reconciliation, Exhibit 3.3b**

Exhibit 3.3b includes the Utility Plant in Service items that were contributed by either the developer or the customers through their connection fees. Instead of depreciating these items, an amortization of CIAC is calculated for each item, equal to its depreciation expense. Contributed assets, plus the accumulated amortization of CIAC (to offset the accumulated depreciation) are deducted from the rate base.

#### **Ratebase Calculations, Exhibit 3.4**

Mountain Sewer's rate base, on which it has an opportunity to earn a return, consists of its investment in Utility Plant in Service (infrastructure, buildings, land, etc.) and the operating funds, or "working capital," necessary to operate for 45 days on a day-to-day basis.

Infrastructure that is contributed to Mountain Sewer by its customers or developer(s) is deducted from the total Utility Plant in Service to ensure that only Mountain Sewer's investment in its facilities are included in its ratebase.

### **Revenue Requirements, Exhibit 3.5**

Revenue requirements are defined as the amount of money that a utility must receive from its customers to cover its costs, operating and maintenance expenses, taxes, capital reserve account funding, and a reasonable return on rate base.

### **Capital Reserves, Exhibit 3.6**

The Division is concerned about the Mountain Sewer's lack of any financial reserves. Reserves are a necessary part of a sound financial management plan for an on-going and effective system. Setting aside reserves is critical to developing and maintaining financial stability and can mean the difference between a system that is self-sustaining and one that may fall victim to disrepair or become financially unstable during even a relatively small emergency. Capital reserves are funded through rates, paid equally by all connected and standby customers, and should be maintained in a protected account and allowed to accumulate or used for capital replacement, improvements and major restorations as the need arises.

The targeted minimum amount to be set aside annually for capital reserves is equal to the company's annual depreciation expense prior to making any adjustments for Contributions in Aid of Construction (CIAC). CIAC is not deducted in calculating the capital reserve because over

time, assets of the company will eventually need repaired or replaced whether or not the asset was invested in by the company or otherwise contributed. Since capital reserves are calculated based on the historical replacement costs for an aging infrastructure they will likely not cover all future capital asset repair and replacement, but will go a long way in creating and maintaining Mountain's Sewer's financial integrity in the years to come.

The capital reserve funding amount is obtained by dividing the Annual Depreciation Expense by the number of total customers and then rounding up to the nearest 25 cents and then multiplying this amount by the total number of customers. See 3.7, F9 for further details.

Mountain Sewer's Tariff, pages T10 through T12 lists the proper uses, required audit trail and necessary disclosures of its Capital Reserve Account.

### **Rate Design, Exhibit 3.7**

Rates for regulated utilities, including the Company, need to be designed to allow Mountain Sewer the opportunity to recover expenses and costs and earn a rate of return.

The rate design consists of three main components:

1. **System Fees** – These fees are needed to fund the fixed system related expenses, which also include the return on investment and taxes. These are paid equally by all connected and standby customers.

2. **Capital Reserve Account Fees** – These are the fees required to fund the capital reserve account and are paid equally by all connected and standby customers.
  3. **Usage Fees** – These fees are required to fund the variable costs incurred primarily by those connected customers who are using the sewer system. These are paid for by only the connected customers.
- **Standby Fees** are the sum of the System Fees plus the Capital Reserve Account Fees.
  - **Connected Customer Fees** are the sum of all three of the above components.

### **Legal Fees, Exhibit 3.9**

This exhibit lists the legal and accounting fees incurred for the complaint, rate increase and special assessment. The Division reviewed the legal and accounting fees as submitted by Mountain Sewer and made adjustments as needed. See Exhibit 3.9 for more details.

The demands placed on Mountain Sewer's attorneys to handle the open dockets in this case were substantial. Until these dockets are resolved, or otherwise agreed upon by all parties, legal fees are continuing to be added to the expenses which the ratepayers must pay for in rates. The Division has asked the Mountain Sewer attorneys to update and submit their expenses to the present time, but further legal costs will require the Division to update the legal expense amount as this process continues. The Division's cut-off date for additions or revisions of expenses in these open dockets is September 13, 2012. The additional legal expense amounts to be added to

the rate schedule are dependent upon the additional amount of work required by Mountain Sewer's attorneys.

On December 28, 2011, check number 1050, was drawn on the checking account of Mountain Sewer Corp, for the amount of \$26,749. According to the invoice supplied by Mountain Sewer and attached to this check, this payment was for legal fees of Smith Hartvigsen for the period of June 26, 2010 through December 15, 2011. Since Smith Hartvigsen has already been paid \$26,749, this amount is deducted from the total amount owed for legal fees for Smith Hartvigsen and the total legal fees.

### **Rate Increase Comparison, Exhibit 3.10**

#### **1. Active Connected Customers**

This rate case involves a large, one-time increase in rates of 283%. To better understand the rate increase, and to fairly compare the current rate to the new recommended rate, the Division has prepared Exhibit 3.10.

The spreadsheet and accompanying graphs best illustrate the true rate increase. The first column shows the original 1986, \$22 monthly rate. The second column shows, that when adjusted for inflation, the same \$22 monthly rate in 1986 would cost \$46 in 2012, or an additional \$24 increase. Since the original \$22 monthly rate did not include an amount set aside for capital reserves, and the new recommended rate has a capital reserve requirement, the amount of the monthly capital reserve funding is also added to the old rate to make the comparison between the

original rate and the new recommended rate comparable. With adjustments for inflation and the capital reserve amount, the true percent increase is a more reasonable 38%.

The last column of Exhibit 3.10 shows, that in addition to adjustments for inflation and the capital reserve, the average net loss, aka developer subsidies, of Mountain Sewer from 1986 through 2010, as calculated in Exhibit 1.6, is also considered in the rate comparisons. Please note, to err on the conservative side in calculating the average amount subsidized by Dr. Catanzaro, the Division used the data that counted connection fees as income. As you can see, the rate adjusted for the developer subsidies is very close to the new recommended rate, even with the capital reserve addition to the new rates, meaning that the new rates are more efficient while also funding the capital reserve.

## **2. Standby Customers**

Mountain Sewer has not previously charged a standby fee. Standby fees are typically charged to those customers meeting the definition in the utility's tariff. Mountain Sewer's tariff defines a standby fee as:

*“the fee charged to the owner of any recorded lot in Mountain Sewer's service area that has access to an installed sewer main and does not currently receive sewer service.”*

Mountain Sewer is obligated to have the sewer system available to its customers 365 days per year, 24 hours a day. Even though standby customers are not connected and actively using the sewer system, expenses are still incurred on their behalf. For example, personnel must be paid to perform maintenance, accounting, billing, management, engineering, etc. on the sewer system to ensure that the system remains healthy and is available for use when a customer wishes to connect to the system. Exhibit 3.2 shows the necessary operating expenses of Mountain Sewer. On the right hand side of the exhibit, Operational Expenses are allocated between System Expenses, which are paid for equally by connected customers and standby customers, and Usage Expenses, which are paid for solely by connected customers. Percentages were assigned to each of the system expenses in order to best allocate the expenses to the customer group that utilized the service.

### **Interim Rates, Exhibit 3.11**

On May 14, 2012 the Commission approved interim rates for Mountain Sewer effective that day. The interim rates were set lower than the recommended rates ultimately calculated by the Division, resulting in an underpayment. The Division recommends that the standby and connected customers pay the difference between the interim rates and the final rates in the THIRD month's billing after the final rates are approved by the Commission. The Division is recommending that the interim rates true-up fee be paid in the third month to help lessen the financial burden of the ratepayers who will also be paying the Special Assessment soon after the final approval of rates by the Commission. The monthly underpayment calculated in Exhibit



3.11 should be multiplied by the number of months between May 14, 2012 and the effective date of the final rates as approved by the Commission.

The difference in connection fees collected at the interim rate amount in excess of connection fees recommended by the Division, should be refunded to the customer.

All other recommended fees and charges remained the same as the interim fees and charges, and require no adjustments.

### **III (b). Docket No. 11-097-03, Special Assessment for Mountain Sewer, Exhibit 3.8**

Mountain Sewer originally requested a Special Assessment of \$171,791.83 to cover various past, present and future expenses.

The amounts requested fit into one of the following four categories:

- 1. Net operating losses.**

These include general operational expenses that Mountain Sewer incurred during the time that Mountain Sewer transferred ownership from Dr. Catanzaro to Valley Utilities to the present. When Valley Utility took over, it was attempting to operate the sewer company on nearly 30 year-old rates and losses mounted each month. The Division is sensitive to

the fact that rates were not sufficient to cover operating costs, but are unable to recommend that these expenses be included in this special assessment or in rates because allowing net operating losses resulting from past or already incurred costs from normal operations to be recovered would constitute impermissible retroactive ratemaking. The Company requested \$47,695.70. The Division recommends nothing for recovery and the net operating loss amount not recommended for recovery is \$47,695.70.

**2. Emergency/Urgent Repair and Replacement of Assets.**

These items represent the repairs and necessary capital replacement, improvements and major restorations needed by the sewer company to make it safe, reliable and provide adequate levels of service. In July 2011 when Valley Utility took over ownership and operations of Mountain Sewer, there were several major operational deficiencies since much of its 25-year-old infrastructure was nearing its typical life expectancy. The aging system and operational deficiencies necessitated the pumping of raw sewage from the lift station to pump trucks, transporting it over local streets and dumping it into manholes in the street. Additionally, there was a valid concern of the possibility of raw sewage contaminating Pineview Reservoir if needed repairs and proper maintenance were not done immediately. Valley Utility Company secured funds through a line of credit and immediately remedied the most urgently needed repairs and deficiencies. The Engineering Report, Exhibit 2, states that all of the work performed was “necessary to maintain the system and continue to address the customer complaints. The prices all

appear to be reasonable,” and that “every effort appears to have been made by Mountain Sewer to keep costs to a minimum.”

Typically, costs incurred prior to the approval of new rates or a special assessment cannot be recovered in future special assessments or rates. However, these expenditures were required immediately and were necessary to make the sewer system safe, reliable and to provide adequate levels of service. The Division made the necessary adjustments to omit them from the Special Assessment, but add them to the ratebase, where the costs can eventually be recovered as part of the ratebase. The amount of costs transferred to the rate schedule is \$63,361.05. See Exhibit 3.3a for their inclusion as an addition to 2011’s Plant Accounts.

**3. Pending and Urgent Repair and Replacement of Assets.**

These items represent the repairs and necessary capital replacement, improvements and major restorations needed in the near future by the sewer company to make it safe, reliable and provide adequate levels of service.

These items are still pending, but need to be done as soon as possible to avoid a potential system shut down. They are not typical or recurring expenses that the sewer company will likely have on a continuing basis. Due to the nature and urgency needed to complete them as soon as possible, it is recommended that these items remain in the Special Assessment. The Engineering Report, Exhibit 2, states that all of the work is

“necessary to maintain the system and continue to address the customer complaints. The prices all appear to be reasonable,” and that “every effort appears to have been made by Mountain Sewer to keep costs to a minimum.”

The Division has also included the finance charge and the adjusted interest expense related to this line of credit. The items remaining in the Special Assessment total \$39,710.08. Based on the lower amount recommended for approval in the Special Assessment, the \$4,411 interest expense was adjusted down proportionally to an amount of \$1,311.

### **Items Recommended for Approval in the Special Assessment**

The pending work required is detailed below:

- a. Stainless Steel Screen for \$14,500** - The screen referred to is a filtration device. Sewer customers have historically flushed debris or rags into the sewer system. This screen is a filtration system that will collect any debris or rags before they reach the pump in the lift station. If such debris reaches the pumps, the pumps will need to be shut down and cleaned out manually. Also, the debris or rags can jam the pump and cause it to burn out. Replacing a burned-out pump costs approximately \$8,000.
- b. Upgrade alarm system for \$6,400** - The alarm system currently installed is old and outdated. The purpose of the alarm system is to alert the system operator if any of the pumps in the lift stations are malfunctioning. Currently, the alarm system works

probably 90% of the time which necessitates the twice-daily checks by Mark Greene who is working for Mountain Sewer as an independent contractor. Upgrading the alarm system is simply necessary based on the system design and geography of the service area. Since effluent must be pumped uphill to the lagoons, any failure of the lift stations can cause flooding or other problems.

- c. **Rebuild Blowers for \$4,500** - The blowers need to be rebuilt in both ponds. If the blowers are not functioning, the ponds do not get aerated and the system capacity is reduced.
- d. **Replace or repair airline valve for \$1,200** - The airline valve is part of the blower system and needs to be repaired for the system to function efficiently and properly.
- e. **Rebuild Damage Blower Control Panel for \$1,156** - The panel that controls the blowers needs to be repaired to allow the system to function properly and efficiently.
- f. **Drain upper pond, repair blowers for \$4,500** - As noted previously, the blowers in both ponds need to be rebuilt. The previous expense listed is for the lower pond and this expense is for rebuilding the blowers in the upper pond.
- g. **Refurbish old Fly gt pumps for \$790** – **This needs to** be repaired for the system to function efficiently and properly.

**h. Reroute storm water drainage manhole for \$1,000** - This is the area that caused the flooding of the condos previously. The manhole will be sealed with a permanent watertight lid and the water will be rerouted. This needs to be done in order to prevent storm water intrusion into the sewer system.

**i. Complete dump station Roto Mill materials” for \$4,103.08** - This expense is for adding roto mill material (essentially ground up asphalt) in the turnaround area so that the road that goes up to the lagoons is accessible in inclement weather and to allow year round access to the lagoon area.

**4. Requested Items for Past Services Performed.**

These two items are past due fees owed for services performed in primarily in 2010. The amounts were initially significantly higher, but Mr. Bowden negotiated the amounts down to what is included in these items. The Division is sensitive to the fact that rates were not sufficient to cover operating costs, but are unable to recommend that these expenses be included in this special assessment or in rates because net operating losses resulting from past or already incurred costs from normal operations cannot be recovered, therefore, the Division made an adjustment to omit this from the Special Assessment. The amounts for past services performed not recommended for recovery is \$17,925.00.

### **Summary of Divisions Recommendation for the Special Assessment**

In summary, regarding the Company's requested Special Assessment for \$171,791.83, the Division recommends that the Special Assessment be approved for \$39,710.08, transfer \$63,361.05 from the Special Assessment to ratebase and disallow \$68,720.00 ( $\$47,695.70 + \$3,100 + \$17,925$ ). The Division recommends that the Special Assessment be paid for equally by the 130 active connections and the 64 standby customers. The Special Assessment recommendation is for a one-time payment of \$204.69 ( $\$39,710.08 \div 194$ ) due in 30 days from the date of Commission approval.

### **Recommended Changes to Tariff No. 2, Exhibit 4**

Mountain Sewer submitted a revised tariff, labeled "Attachment 8.1," in its response to the Division's fourth Data Request. The Division has attached the tariff as its Exhibit 4. The Division recommends item 9 on page T8 of the tariff be revised to reflect the changes below:

**9. Responsibility.** The Company will be responsible for the operation and maintenance of the main sewer collection facility (usually collection pipe eight (8) inches or over) in the public street or on a perpetual easement granted to the Company. The Company's responsibility shall extend to the from the main sewer collection facility to the property line of the Customer.

The building owner or Customer will be responsible for maintenance and operation of the sewer service lateral from the building to the ~~main sewer collection facility~~ Customer's property line.

The Division recommends that the remainder of the tariff be approved as submitted.

**Customer Impact**

The Division prefers to recommend that an increase of this scale to be phased in over a period of time. Unfortunately, with relatively so few customers and pending needs, Mountain Sewer does not have the luxury of time. In small utility companies, such as this, there are few customers among whom to spread the costs, thus creating higher than desirable rates. While the Division is sensitive to recommending such a large increase, the increase is necessary to pay for the costs of operations and to establish a capital reserve through its revenues.

**DIVISION RECOMMENDATIONS:**

***Rates, Charges and Fees***

Description		Current Tariff	Requested by Mountain Sewer	Recommended by Division
Monthly System Expense	System Fees	\$0.00	\$32.36	\$10.25
	Capital Reserve Fees	\$0.00	\$15.21	\$15.00
Total Monthly System Expenses	Standby Fees	\$0.00	\$47.57	<b>\$25.25</b>
Monthly Usage Fees	Connected Customers	\$22.00	\$26.17	\$59.00
Total Monthly Fee for Connected Customers	Connected Customers		\$73.75	<b>\$84.25</b>
One-time Payment Special Assessment	Connected & Standby	NA	\$1,240.94	<b>\$204.69</b>



Description	Current Tariff	Requested by Mountain Sewer	Recommended by Division
Underpayment of Rates based on Interim Rate Amounts	Because the approved Interim Rates were set lower than the recommended rates, customers must submit the total underpayment once the final rates are approved. - Monthly Shortfall for Standby Customers is: \$.85 - Monthly Shortfall for Connected Customers: \$27.19		
Connection Fee	Connected Under Existing Street	\$3,000.00	\$5,000.00
	Connected Before Street Installation		\$3,000.00
Hook-up Fee	None	\$300.00	\$300.00
Turn-on Fee	None	\$100.00	\$100.00
Turn-off Fee	None	\$100.00	\$100.00
Late Fee	18% per Annum	18% per Annum	18% per Annum

**CONCLUSION:**

The Division believes that the above recommended rates, fees and charges represent an appropriate balancing of ratepayer interests and the interests of Mountain Sewer.

The Division recommends the Commission approve:

- Rates, fees and charges as listed above.
- The Company's tariff pending the recommended changes.
- Standby and connected customers pay the difference between the interim rates and the final rates in the THIRD month's billing after the final rates are approved by the Commission.
- The Special Assessment for \$39,710.08, transfer \$63,361.05 from the Special Assessment to ratebase and disallow \$68,720.00. The Special Assessment shall be paid for equally by the 130 active connections and the 64 standby customers in a one-time payment of \$204.69, due within 30 days from the date of Commission approval.
- Transfer of Ownership of Mountain Sewer and Lakeview Water to Valley Utility.
- The complaint in Docket 11-097-01 be dismissed.

The Division believes that its recommended rates, fees and charges and fees set forth above are just and reasonable and consistent with the public interest and, therefore, the Division recommends that the Commission approve these new rates and charges.