



Jim Nash

May 21, 2018

Mr. Brian Baker, Chairperson
GLWA Audit Committee
Great Lakes Water Authority
735 Randolph St., Suite 1900
Detroit, MI 48226

Re: Response to Foster Group Memorandum, April 19, 2018
Cost of Service FY 2018-19

Dear Chairperson Baker:

On April 20, 2018, appearing before the GLWA Audit Committee, the Oakland-Macomb Interceptor Drain Drainage District ("OMID") provided commentary on the Foster Group response dated April 19, 2018 ("Foster Group Memorandum") to previously raised questions and concerns on the proposed FY 2018-19 Cost of Service charges to the OMID. The Audit Committee requested that the OMID prepare its response to the Foster Group Memorandum. Below are our comments and concerns regarding the FY 2019 Sewer Charges to the OMID:

1. Foster Group Memorandum:

"Capital Revenue Requirement Allocations

Since the establishment of the FY 2011 Sewage Disposal Charges, GLWA allocations of capital revenue requirements (including debt service) have been allocated to cost pools and Customers based on a "Utility Basis" approach. Under this approach statistics from the fixed asset records of the Sewer Utility are used to allocate capital costs. For instance, if 1% of the representative capital asset value for the Sewer System is related to OMID specific assets, then 1% of the capital revenue requirements (including debt service) are allocated to OMID."

OMID Response:

In 2009, the City of Detroit ("City") transferred to the OMID certain sanitary sewer interceptors, pump stations, meters and appurtenant facilities originally constructed and owned by the City. As part of this OMID/City transaction, the City also entered in a "Settlement and Release of Certain Rate Disputes" agreement dated October 22, 2009 ("Release Agreement"). According to the Release Agreement, the only debt service that was to be assigned to the OMID was the debt service associated with capital improvements at the Northeast Pump Station ("NEPS"). The pertinent portion of the Release Agreement is restated below:

“3. Summary of Post-Closing Debt

a. The parties agree that after the Oakland-Macomb Interceptors have been transferred to the District and the Macomb Interceptors to Macomb County, the only debt service included in the sewer rates for the District, other than debt service allocated "common-to-all" or "suburban common-to-all," will be debt service associated with capital improvements at the Northeast pump station (excluding meters at the Northeast Pump Station). Further, no debt service in the rates for the C-OSDS or the MCWDD in FY2008/2009 and associated with the meters listed in Section l(d) will be included in the District's rates as a suburban common-to-all charge in the FY 2009/2010 rate year or subsequent rate years.”

Regardless of whether GLWA (as the successor entity to the City) utilizes Cash Basis, Utility Basis or any other basis, any debt service assigned to “OMID specific” other than for the Northeast Pump Station (“NEPS”) would be inconsistent with the Release Agreement. Accordingly, in addition to the NEPS, the City (and now GLWA) should not have assigned any debt service for the North Interceptor East Arm since 2009.

2. Foster Group Memorandum:

“Operating Revenue Requirement Allocations

For purposes of assigning operating costs to the OMID cost pool, the same approach (relative inch miles) is used to assign NIEA related interceptor costs. In the FY 2019 Cost of Service Study this resulted in approximately \$0.43 million of direct operating revenue requirements allocated to the OMID cost pool.

With regard to the NEPS operating costs, GLWA allocations of all budget operating expenses related to sewer pumping stations (including maintenance, SCADA, etc.) have been assigned to individual sewer pumping stations based on relative electric usage or costs. This approach was established several years ago, as detailed specific pumping station maintenance costs, etc. were difficult to isolate. For purposes of the FY 2019 Cost of Service Study, we obtained budgeted electric utility costs for several years. The relative budgeted electric utility costs for the NEPS, as a proportion of budgeted electric utility costs for all GLWA sewer pumping stations, ranged from 24% to 40%. In our FY 2019 Cost of Service Study we allocated 25% of all sewer pumping station operating expenses to the NEPS, which resulted in direct operating costs totaling \$5.88 million being assigned to the OMID cost pool. So our FY 2019 Cost of Service Study included \$6.05 million of direct operating revenue requirements assigned to the OMID cost pool, which was then directly assigned to the OMID Customer.

The combined total revenue requirement allocated to the OMID cost pool in the FY 2019 Cost of Service Study was \$10.50 million.”

OMID Response:

As indicated above, the NEPS is assigned costs based on electrical usage which was established several years ago by the City, and continued under GLWA. However, the OMID Wastewater Disposal Services Contract dated October 22, 2009 (“Service Contract”), indicates that such allocations requires justification, as well customer (i.e. OMID) consent (which “shall not be unreasonably withheld”). To assist us in understanding GLWA’s costs allocations, we request GLWA provide justification that establishes a reasonable relationship between electrical usage and the allocations of other costs associated with the operations of the NEPS.

In addition, although we understand that the transition from DWSD to GLWA is still a work-in-progress, the Service Contract provides that separate accounts should have been established for the NEPS to account for all costs associated with this facility. To our knowledge, this process was never implemented by the City prior to, or by GLWA, after the transfer of the regional system. It would be helpful to understand whether GLWA intends to establish separate accounts to which all costs will be charged by employees for in-house labor, parts, equipment and contractual services, or whether GLWA intends to continue to allocate these costs. If the latter, we will need justification as to why it is more cost effective to allocate these costs rather than directly account and bill for them. For purposes of this letter, we have restated the relevant portions of the Service Contract below concerning this particular issue:

“22.02 Northeast Pump Station Costs and Accounting. Customer shall be responsible for the payment of all costs arising out of or related to the operation, maintenance, improvement and repair the Northeast Pump Station. City will establish separate accounts for the Northeast Pump Station to which all costs will be charged by employees for in-house labor, parts and equipment and for contractual services. In the event the City determine that it is more cost effective to allocate certain labor functions or establish a flat monthly charge rather than directly account for them, it may do so with Customer's prior consent which consent shall not be unreasonably withheld so long as City has provided a acceptable cost allocation justification for the proposed allocation or flat charge. An allocation or flat charge will be subject to periodic review and adjustment at intervals no greater than five years. City will maintain supporting records for all Northeast Pump Station charges for 12 months after the Look Back for the relevant financial year has been completed and the associated detailed rate notebook has been made available to Customer. Supporting records will be available for Customer review upon written request. City will invoice Customer directly for the cost of operating, maintaining improving and repairing the Northeast Pump Station on a quarterly basis. These cost will not be recovered through the rates.”

During the April 20 Audit Committee meeting, we also indicated that there are two customers which receive customer specific charges associated with sewage pump stations: the City and the OMID. At that time, we inquired as to how the City was assessed by GLWA for its customer specific sewage pumping stations, and were informed that Shared Services Agreement establishes the charges for the operations and maintenance of the City’s sewage pump station.

We have reviewed the Shared Services Agreement between the City and GLWA, and in particular, Schedule #OPS-008 which identifies the charges for GLWA services. Attached is a copy of Schedule #OPS-008. Under the Shared Services Agreement Schedule #OPS-008, GLWA provides 24/7 operations, maintenance, engineering and management services for the following City facilities: (1) Belle Isle Main Pump Station and Combined Sewer Overflow Facility; (2) Bluehill Pump Station; (3) Fischer Pump Station; and (4) Woodmere Pump Station. According to Schedule #OPS-008 (for FY 2016 Budget), the City's share of the total annual estimated cost to operate and maintain these facilities, is \$1,393,598 (see attachment for specific services provided). Moreover, the City is directly responsible for all utilities. Any emergency or extraordinary repairs are separately billed with supporting documentation. Using this information, it appears that the OMID is being charged significantly more for a similar level of service for operations and maintenance associated with NEPS than the City is for its pump stations. GLWA needs to justify this disparate treatment for similar levels of service. Further, based on the Shared Services Agreement, GLWA is currently capable of directly billing for services provided.

Remaining Foster Group Memo Item:

During the April 20 Audit Committee meeting, the Committee did not address the treatment of return on rate base and depreciation expense. We are willing to discuss this matter as well as the responses above, at the convenience of the Audit Committee.

On behalf of the Oakland-Macomb Interceptor Drain, thank you for taking the time to review our responses to the issues raised in the Foster Group Memorandum. If you have any questions regarding this matter please feel free to contact me.

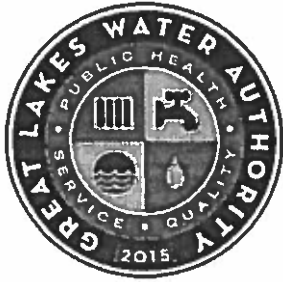
Sincerely,



Raphael Chirolla

Enclosure

cc: Robert Daddow, Director, GLWA Audit Committee
Gary Brown, Director, GLWA Audit Committee
Sue F. McCormick, Chief Executive Officer
William N. Wolfson, Chief Administrative and Compliance Officer
Nicolette Bateson, CPA, CFO/Treasurer
Randal M. Brown, General Counsel



**Shared Services Agreement
Schedule
Operations: Systems Control Center, Detroit Only
Sewer Pump Stations
and Belle Isle CSO Facility**



| | |
|---|---|
| Shared Service Schedule # | OPS-008 |
| Service Provider | Great Lakes Water Authority |
| Service Subscriber | City of Detroit / Detroit Water and Sewerage Department - Retail |
| Description of Service | Provide operations and maintenance of sewer pump stations and a combined sewer overflow facility that only service Detroit. |
| Description of Requirements, Level of Service, Hours of Service | <p>Level of Service (Typical): Provider will provide monitoring, operation and maintenance activities for the following facilities that serve the City of Detroit: Belle Isle Main Pump Station and CSO Facility, Bluehill Pump Station, Fischer Pump Station, and Woodmere Pump Station. Provider shall be responsible for operating and servicing the equipment consistent with current planning documents, including but not limited to the Wet Weather Operational Plan and Needs Assessment Study. This includes:</p> <p><i>Operations:</i></p> <ul style="list-style-type: none"> • 24 x 7 Control and Monitoring of process from the SCC Control Room. • Traveling Operator site visits every other day for physical inspection • Emergency response to equipment malfunction or to address any alarm condition <p><i>Maintenance:</i></p> <ul style="list-style-type: none"> • Mechanical • Electrical • I&C • Building • Grounds Maintenance • Cleaning • Emergency PMs <p><i>Engineering/Management:</i></p> <ul style="list-style-type: none"> • Monthly Site Visits • Weekly KPI Review • Utility Data Review • Wet weather event analysis • Data Gathering • Report Generation • Compliance Reporting |

| | |
|---|---|
| | <p>Emergency repairs shall be effectuated by Provider as-needed, but will be reported to Subscriber as soon as practical. For any repair, which exceeds \$50,000 or 50% of the replacement capital cost to replace the equipment, Provider shall notify Subscriber prior to initiating repair.</p> <p>Provider shall provide Subscriber with annual maintenance report which details services rendered. The report shall include, at a minimum types of repairs performed, costs of repairs, asset criticality rating and remaining useful life for each asset operated and maintained by Provider for Subscriber. This report will be used by Subscriber to budget for capital investments for the Detroit only assets and associated infrastructure. Access to the Provider work order management system will be provided to Subscriber for review of data on a more frequent basis, if desired.</p> <p>Provider will also notify Subscriber Field Services immediately when a pressure or flow issue is monitored in the system. Subscriber Field Services will be responsible for contacting Subscriber Public Affairs group to provide/coordinate retail customer notifications for pressure issues, boil water advisories, etc.</p> |
| Related Services | N/A |
| Assumptions, Dependencies, and Requirements | All utilities associated with Subscriber locations will be paid by Subscriber |
| Space/Location | <ul style="list-style-type: none"> • Belle Isle Combined Sewer Overflow Facility • Belle Isle Main Pump Station • Blue Hill Pump Station • Fischer Pump Station • Woodmere Pump Station |
| Staffing | N/A |
| Duration (phasing), extensions | Until terminated. |
| Cost Methodology | <p>Phase 1 Methodology: Until the commencement of the Phase 2 cost methodology, the Service Cost shall be determined as follows: The Systems Operations Center (SOC) Shared Service Agreement cost was based upon the 2015-2016 approved budget cost center Systems Operations Control. This cost includes labor, fringe benefits, contractual services, supplies, repairs & maintenance, and other direct costs.</p> <ol style="list-style-type: none"> 1. The allocation of costs was based on the total number of major and minor sites monitored and operated by the SOC. There were a total of 35 major sites and 15 minor sites. The major sites have been weighted at 2x the minor sites for the purposes of the pro ration. Bluehill pump station was identified as a major site. The Belle Isle CSO and pump station were identified as a single minor |

| | |
|--|--|
| | <p>site. Woodmere pump station was identified as one minor site. Fisher pump station was identified as one minor site.</p> <p>2. The cost center FY2015-2016 budgeted expense for SOC was then allocated based upon percentage determined from the evaluation in "1" above.</p> <p>Phase 2 Methodology: Commencing on July 1, 2017, or such later date as agreed to by the Director and the CEO, the Parties shall determine the Service Costs based on the results of a study of the distribution of work in the SOC, conducted with the goal of capturing a more accurate allocation of the Service Costs for this Service. This study shall be completed no later than January 1, 2017 or such later date as agreed to by the Director and the CEO.</p> |
| | <p><u>Expense reimbursement-</u> Costs incurred above and beyond the fixed fee for emergency/extraordinary repairs shall be invoiced separately and include description of service provided. These costs shall be reimbursed at time and materials.</p> |
| Separation Costs | <p>Separation Costs are anticipated as follows: Stranded Costs associated with the lay-off of employees, including unemployment benefits. Transition Costs associated with transferring records of the Services provided to Subscriber's new data/records system.</p> |
| Frequency of Payment (if other than monthly) | N/A |
| Notice of Termination of Entire Service or Element | <p>Provider may terminate this schedule upon two years advance written notice to the Subscriber; and Subscriber may terminate this schedule upon 180 days advance written notice to the Provider.</p> |
| Contact for City/DWSD – R | Title: Deputy Director/Chief Engineer |
| Contact for GLWA | Title: Chief Operating Officer |
| List of Exhibits & Attachments | Exhibit A: Cost Methodology Initial Allocation |
| Approved for GLWA (w/Date): | Sue McCormick (12/9/2015) |
| Approved for City/DWSD-R (w/Date): | Gary Brown (12/9/2015) |
| Effective Date: | January 1, 2016 |

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EXHIBIT A
COST METHODOLOGY INITIAL ALLOCATION

Cost Allocation Calculations for OPS-008 Systems Control

DWSD BUDGET DETAIL from Approved Budget FY 2016

| <u>GL Account</u> | <u>Cost Center Description</u> <u>Cost Center</u> <u>Expense Description</u> | Systems Operations Control 412301 <u>FY16 Budget</u> |
|-------------------|--|--|
| 601100 | Salaries-Full Time | 2,456,308 |
| 601300 | Salaries - Overtime | 40,000 |
| 601400 | Salaries-Shift Premium | 2,000 |
| 601500 | Salaries-Holiday Premium | 1,000 |
| 602100 | Wages- Full Time | - |
| 602300 | Wages- Overtime | 800,000 |
| 602400 | Wages- Shift Premium | 50,000 |
| 602500 | Wages- Holiday Premium | 20,000 |
| 603100 | Emp Benefits-Pensions | 141,238 |
| 603101 | Emp Benefits-Pension-UAAL | - |
| 603120 | Non Actuarial | - |
| 603200 | Emp Benefits-Hospitalization | 364,066 |
| 603220 | Empl Ben-Hosp General Retiree | - |
| 603300 | Emp Benefits-Social Security | 187,908 |
| 603400 | Unemployment | 9,198 |
| 603405 | Workers' Compensation | 75,409 |
| 603900 | Emp Benefits-Miscellaneous | 1,589 |
| 604100 | Other Comp-Unused Sick Leave | 68,193 |
| 604200 | Other Comp-Longevity | - |
| 605100 | Group Life Insurance | 7,727 |
| 605200 | Eye Care Premium | - |
| 605205 | Eye Care-Active Civilian | 3,593 |
| 605210 | Eye Care-Retired Civilian | - |
| 605700 | Health Care Reserve | 49,126 |
| 605415 | Service Death | - |
| 605500 | Income Protection | 1,611 |
| 605620 | Dental Active | 31,536 |
| 605640 | Dental Retired | - |
| 611200 | Auditing | - |
| 613100 | Legal | - |
| 616100 | Consultant Fees-Mgt Consult | - |
| 617200 | Contract Scv-Bldg Maint-Misc | 113,600 |
| 617400 | Contract Services-Info Tech. | 260,000 |
| 617900 | Contract Svcs-Other-Misc | 7,967,458 |
| 617903 | Pers Servs Contract-Pd On P/R | 9,400,000 |
| 620100 | Office Supplies | - |
| 621100 | Oper Supplies-Medical | - |
| 621300 | Oper Supplies-Automotive | - |

Cost Allocation Calculations for OPS-008 Systems Control

DWSD BUDGET DETAIL from Approved Budget FY 2016

| STEP 1 | GL Account | Cost Center Description Cost Center | Systems Operations Control |
|--------|------------|--|----------------------------------|
| | | | 412301 FY16 Budget |
| | 621400 | Oper Supplies-Janitorial | 3,600 |
| | 621500 | Oper Supplies-Fuel | - |
| | 621600 | Operating Supplies-Chemicals | - |
| | 621900 | Oper Supplies-Miscellaneous | 308,000 |
| | 622100 | Repairs & Maint-Automotive | - |
| | 622200 | Repairs & Maint-Bldgs&Ground | - |
| | 622300 | Repairs & Maint-Equipment | 267,200 |
| | 622301 | Hardware Maintenance | - |
| | 622302 | Software Maintenance | 19,600 |
| | 622400 | Repairs & Maint-Facilities | 480,000 |
| | 622900 | Repairs & Maint-Misc | - |
| | 623100 | Uniforms, Laundry, Cleaning | - |
| | 626010 | Advertising | - |
| | 626100 | Printing | - |
| | 626300 | Insurance Premium | - |
| | 626310 | Insurance- Other | - |
| | 626400 | Rentals- Buildings | 20,972 |
| | 626410 | Rentals- Computers | - |
| | 626415 | Rentals- Office Equipment | - |
| | 626430 | Rentals- Miscellaneous | - |
| | 626500 | Dues & Miscellaneous | - |
| | 626600 | Postage | - |
| | 626700 | Telecommunications | - |
| | 626702 | Data Com Equip | - |
| | 626800 | Utilities | - |
| | 626801 | Utilities-Water | 10,000 |
| | 626802 | Utilities-Gas | 65,000 |
| | 626803 | Utilities-Steam | - |
| | 626804 | Utilities-Electricity | - |
| | 626805 | Utilities-Sewage | - |
| | 626806 | Utilities-Pld Electricity | - |
| | 627105 | Private Car Reimbursements | 500 |
| | 627110 | Purchased Services - Other | - |
| | 627135 | Pur Svcs-Law Dept | - |
| | 627140 | Pur Svcs-Staff Services | - |
| | 627175 | Pur Svcs-Personnel | - |
| | 627190 | Pur Svcs-Shared Svcs Chg | - |
| | 627195 | Employee Uniform Expense | - |

Cost Allocation Calculations for OPS-008 Systems Control

DWSD BUDGET DETAIL from Approved Budget FY 2016

| GL Account | Cost Center Description Cost Center Expense Description | Systems Operations Control 412301 FY16 Budget |
|------------|---|---|
| 627225 | Other Oper Svc-Miscellaneous | - |
| 627230 | Employee Parking | 200 |
| 627255 | Photographic Service | - |
| 628100 | Travel | - |
| 628200 | Training | - |
| 628208 | Training-Tuition Reimbursement | - |
| 628500 | Miscellaneous Expense | - |
| 628501 | Misc-License,Insp&Permit Fees | - |
| 628508 | Violation Penalties | - |
| 633100 | Major Rep - Plant Equipment | - |
| 633150 | Major Rep - Other Equip | - |
| 644111 | Capital Outlay - Equipment - Other Plant | - |
| 644114 | Capital Outlay Equipment Office Furniture | - |
| 644900 | Acquisitions - Fixed Asset - Other | - |
| 645260 | Capital Outlay - Equipment Transportation | - |
| 661100 | Damage Claims | - |
| 703100 | Interest On Bonded Debt | - |
| 704100 | Retirement Of Debt-Principal | - |
| 707100 | Property Taxes | - |
| 711700 | Bad Debts | - |
| | Total GROSS Budget | 23,226,631 |

Cost Allocation Calculations for OPS-008 Systems Control

Cost Allocation based on FTEs

| | | Sites | # of Sites | Site Equivalents |
|---------------|-----------------------------|-------|------------|------------------|
| STEP 1 | Total Major Site | | 35 | 70 |
| | Total Minor Sites | | 15 | 15 |
| | Total Site Equivalent | | | 85 |
| | Blue Hill | Major | | 2 |
| | Belle CSO & Pump Station | Minor | | 1 |
| | Woodmere | Minor | | 1 |
| | Fischer | Minor | | 1 |
| | Total DWSDR Equivaent Sites | | | 5 |
| | % Retail Hrs | | | 6% |

Step 2

| | | |
|-----------------------|---------------|--------------|
| Total Systems Control | \$ 23,226,631 | FY 16 Budget |
| DWSD-R Share | \$ 1,393,598 | DWSD-R |
| GLWA Share | \$ 21,833,033 | GLWA |
| Monthly Cost | \$ 116,133 | |



Audit Committee

Friday, April 20, 2018 at 8:00 a.m.

5th Floor Board Room, Water Board Building
735 Randolph Street, Detroit, Michigan 48226
GLWater.org

MEETING BINDER ADDENDUM #1

- ✓ *Agenda Item #6D - Report: Responses to Questions from Oakland County Drain Commissioner's Office*



THE FOSTER GROUP

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MEMORANDUM

FY 2019 Sewer Charges to OMID

April 19, 2018

To: Nicolette Bateson

From: Bart Foster

You have asked for commentary and observations regarding a potential response to public comments made by representatives of the Oakland Macomb Interceptor Drain District (OMID) at the GLWA Audit Committee meeting on February 23. We have reviewed the comments, which appear to request modifications to proposed FY 2019 Sewer Charges to reflect four specific areas of inquiry. Herein we present background information, set forth our understanding of OMID's request, and provide a summary of our analyses and perspective regarding the request.

Background:

The GLWA cost allocation methodology¹ for purposes of establishing Sewer service charges includes a "customer specific" cost pool designed to capture the costs related to GLWA facilities that serve only the OMID. These facilities include the Northeast Sewer Pumping Station ("NEPS"), and the portion of the North Interceptor East Arm ("NIEA") downstream of the NEPS that conveys flow *only from* OMID. The cost of service allocation methodology has traditionally employed slightly different approaches for assigning capital and operating revenue requirements to this cost pool.

Capital Revenue Requirement Allocations

Since the establishment of the FY 2011 Sewage Disposal Charges, GLWA allocations of capital revenue requirements (including debt service) have been allocated to cost pools and Customers based on a "Utility Basis" approach. Under this approach statistics from the fixed asset records of the Sewer Utility are used to allocate capital costs. For instance, if 1% of the representative capital asset value for the Sewer System is related to OMID specific assets, then 1% of the capital revenue requirements (including debt service) are allocated to OMID.

GLWA's review of the interceptor inventory indicates that the NIEA segment in question represents approximately 3.5% of all GLWA interceptors, based on an "inch mile" analysis. For purposes of the FY 2019 Cost of Service Study, we assigned 3.5% of all interceptor capital revenue requirements to the OMID cost pool. This created a direct capital revenue requirement of approximately \$0.78 million.

¹ The GLWA methodology is consistent with the methodology of the predecessor entity, DWSD.

Our cost of service study included a review of the GLWA asset records, which indicated that the net book value of \$19.6 million assigned to the NEPS. This NEPS asset value (and the representative annual depreciation expense) amounted to approximately 1.2% of the overall capital asset structure, and we used this ratio to subsequently allocate approximately \$2.81 million of direct capital revenue requirements. So our FY 2019 Cost of Service Study included \$3.59 million of direct capital revenue requirements assigned to the OMID cost pool, which was then directly assigned to the OMID Customer².

Operating Revenue Requirement Allocations

For purposes of assigning operating costs to the OMID cost pool, the same approach (relative inch miles) is used to assign NIEA related *interceptor* costs. In the FY 2019 Cost of Service Study this resulted in approximately \$0.43 million of direct operating revenue requirements allocated to the OMID cost pool.

With regard to the NEPS operating costs, GLWA allocations of all budget operating expenses related to sewer pumping stations (including maintenance, SCADA, etc.) have been assigned to individual sewer pumping stations based on relative electric usage or costs. This approach was established several years ago, as detailed specific pumping station maintenance costs, etc. were difficult to isolate. For purposes of the FY 2019 Cost of Service Study, we obtained budgeted electric utility costs for several years. The relative budgeted electric utility costs for the NEPS, as a proportion of budgeted electric utility costs for all GLWA sewer pumping stations, ranged from 24% to 40%. In our FY 2019 Cost of Service Study we allocated 25% of all sewer pumping station operating expenses to the NEPS, which resulted in direct operating costs totaling \$5.88 million being assigned to the OMID cost pool. So our FY 2019 Cost of Service Study included \$6.05 million of direct operating revenue requirements assigned to the OMID cost pool, which was then directly assigned to the OMID Customer³.

The combined total revenue requirement allocated to the OMID cost pool in the FY 2019 Cost of Service Study was \$10.50 million.

Pending Potential Operating Agreement

We have participated in several meetings between GLWA and OMID representatives as they have sought to establish an “operating agreement regarding the OMID specific facilities addressed in this memorandum. Elements of that potential operating agreement would impact the cost allocation approaches and results discussed above.

² Table 3 in the FY 2019 Cost of Service Study Report contains a “Net Capital” Revenue Requirement line item that includes proportional allocation of certain other “indirect” non-operating items, such as the Lease Payment, etc. These indirect elements result in the OMID “Net Capital” Revenue Requirement totaling \$3.99 million in the Cost of Service Study Report.

³ Table 3 in the FY 2019 Cost of Service Study Report contains a “Net Operating Expenses” Revenue Requirement line item that includes proportional allocation of certain other “indirect” operating items, such as the operating portion of the pension obligation, etc. These indirect elements result in the OMID “Net Operating Expenses” Revenue Requirement totaling \$6.52 million in the Cost of Service Study Report.

OMID Request, Analyses, and Perspective:

1. *Reflect the treatment of debt service for the OMID only rate category consistent with the October 22, 2009 Settlement and Release of Certain Rate Disputes as stated in paragraph 3.a of that document.*
 - We believe that the reference in the OMID correspondence is taking a position that the district should not be allocated **any** capital revenue requirements associated with the portion of the NIEA that conveys only OMID flow. We do not agree with that conclusion. We believe that the agreement that is cited in the referenced document predates the agreements established as part of the Rate Simplification Initiative. In any event, we encourage this issue to be further explored and discussed as part of the negotiations towards the Operating Agreement. For purposes of our hypothetical analysis summarized in the table that follows, we have reflected the calculated effect of removing such capital revenue requirements from the OMID cost pool, which would **reduce** the direct OMID cost pool allocated revenue requirements by approximately \$0.78 million. However the OMID share of the reallocated common-to-all (“CTA”) revenue requirement would **increase** by \$0.13 million, resulting in a net **decrease** of \$0.65 million.
2. *Adjust the assets of the Northeast Pump Station based on the results of the Northeast Pump Station asset inventory review performed on February 2, 2018 with representatives from OMID and GLWA.*
 - As noted in the request, subsequent to the establishment of the proposed FY 2019 charges, additional review of the capital asset data reported for the NEPS has been conducted. It is our understanding that the parties are in basic agreement that the asset records should be adjusted to reflect the results of that review, and that the adjustments will result in a \$5.2 million reduction in the 6/30/17 net book value allocated to the NEPS – which would result in a revised total of approximately \$14.4 million. For purposes of our hypothetical analysis summarized herein, we have reflected the calculated effect of adjusting the capital revenue requirement allocations accordingly. Based on our analysis, this would **reduce** the direct OMID cost pool allocated revenue requirements by approximately \$0.82 million. However the OMID share of the reallocated common-to-all (“CTA”) revenue requirement would **increase** by \$0.12 million, resulting in a net **decrease** of \$0.70 million.
3. *Adjust the OMID only cost category revenue requirements to reflect any changes which may occur pending the review of electrical costs.*

- As noted in the request, subsequent to the establishment of the proposed FY 2019 charges, additional review of the sewer pumping station electric use and costs has been conducted. While the analysis continues⁴, the initial findings indicate that the NEPS accounts for approximately 36% of recent pumping station electric *bills*, and approximately 44% of recent total pumping station electric *usage*. Had we the benefit of this additional analysis at the time we conducted the FY 2019 Cost of Service Study, we likely would have allocated *at a minimum* 35% (rather than the 25% original figure) of total sewer pumping station operating revenue requirements to the NEPS. This hypothetical adjustment would have resulted in a \$2.74 million *increase* to the operating revenue requirements allocated to the OMID cost pool. However the OMID share of the reallocated common-to-all (“CTA”) revenue requirement would *decrease* by \$0.45 million, resulting in a net *increase* of \$2.49 million.
- As shown in the table, the net impact of incorporating all of the hypothetical adjustments noted above would result in a net increase of approximately \$0.94 million. Given that the parties are negotiating an Operating Agreement, and that GLWA is exploring a “Charges Stability Adjustment” to reflect potential adjustments of actual costs, we do not believe it is prudent to modify the originally proposed FY 2019 Sewer Charges.

Hypothetical Analysis Summary
 FY 2019 OMID Cost of Service Calculations - \$ millions

| | <u>OMID Specific</u> | <u>Share of CTA</u> | <u>TOTAL</u> |
|---|----------------------|---------------------|--------------|
| Proposed FY 2019 Charges | 10.50 | 67.79 | 78.29 |
| What If Remove NIEA Int Capital? | (0.78) | 0.13 | (0.65) |
| What If Adjust NEPS Capital? | (0.82) | 0.12 | (0.70) |
| Subtotal Hypothetical Capital Adjustments | (1.60) | 0.25 | (1.35) |
| What If Adjust NEPS O&M Alloc to 40%? | 2.74 | (0.45) | 2.29 |
| Total Hypothetical Adjustments | 1.14 | (0.20) | 0.94 |
| Hypothetically Recalculated Rev Req'ts | 11.64 | 67.59 | 79.23 |

4. *At the January 31, 2018 GLWA/OMID meeting, GLWA stated depreciation expenses for the 2018-19 sewer rates will be utilized at 60% of the book value. For the formation of GLWA, Duff and Phelps analyzed the GLWA assets, stated their values for the beginning*

⁴ The additional review includes an analysis of the amount of wastewater volume handled by each sewer pumping station. The initial estimate indicates that the NEPS handles approximately one-third of all flows that utilize GLWA sewer pumping stations.

balances, and revised the remaining lives of the assets. Why use 60% instead of the full amount of the depreciation expenses, does GLWA dispute the accuracy of their book values? Further, if GLWA goes forward with the 60% for 2018-19 sewer rates, is there a plan to move towards utilizing the full amounts of depreciation expense in the future?

- As noted in the request, the GLWA capital assets were subjected to a valuation analysis conducted by Duff and Phelps, which was required to complete the creation of GLWA. The leased regional assets were booked at an acquisition value based on the Duff and Phelps analysis, which resulted in an increase in the net book value of the “acquired” assets. However it also resulted in a significant increase in the annual depreciation expense. In our opinion, GLWA does not dispute the accuracy of the book values not the depreciation expense, but also recognizes (as do we) that the changes produced by the asset valuation changed the dynamic of the overall asset structure. For purposes of the FY 2019 Cost of Service Study, we sought to strike a balance between the portion of the capital revenue requirements that were allocated (under the Utility Basis approach) based on net book value, and the portion that were allocated based on annual deprecation expense. The approach we applied successfully accomplished this balance, and adhered to the overarching stability objectives of the GLWA charge methodology initiatives. We recommend that future cost of service studies continue to embrace these objectives with respect to this specific issue.

We trust that this discussion is responsive to the request, and we are prepared to discuss this matter at your convenience.