

ALPENA TOWNSHIP

PUBLIC INFORMATION SESSION

Re. WATER AND SEWER RATES

December 7, 2015
Granum Theatre, Alpena Community College

How Do the City and Township Water and Sewer Systems Relate?

- Alpena Township purchases bulk water supply services and bulk sewage treatment services from the City of Alpena.
 - The City owns and operates a water plant and a sewage treatment plant, providing water and sewer service to its own local retail end-users and providing bulk wholesale service to the Township at various points along the Township/City limits.
 - The Township re-sells these wholesale services to its own end-users on a retail basis.
 - The Township performs 100% of its own local delivery of water and collection of wastewater, administration, operating, billing, customer service, and maintenance for its own extensive water and sewer systems, which the Township built and owns (*i.e.*, services that the City provides for its own local retail end-users).

How Do the City and Township Systems Relate?

- Both the Township's and the City's water and sewer systems consist of (1) networks of mains which deliver bulk services; and (2) local distribution systems.
 - A portion of the City's network of mains is used to service the Township at the Township/City limits.
 - Meters at the Township/City limits measure the water flowing into the Township's system, and measure the sewage collected from the Township's system.
 - The City bills the Township for water and sewer based on these bulk meter readings.
 - The City's local distribution systems (*e.g.*, service to homes and other buildings within the City) are not used to provide water and sewer service to the Township.

History of the Township's Water & Sewer Relationship with the City of Alpena

- 1960s – Baby Steps

- The Township developed three separate water districts, presumably served with water provided by the City.
- We no longer have references as to how rates were charged by the City to the Township under this arrangement.

History of the Relationship, cont.

- 1969 – More Baby Steps
 - Township and City entered into a contract for water and sewer services to serve Township Water/Sewer District #2.
 - Contract provided a rate for water and sewer.
 - Contract allowed the City to change rates by giving timely notice to the Township.
 - Water was billed at a designated rate; sewer was set at 50% of the water rate.
 - Contract provided for a 5% late charge, and 6% annual interest.

History of the Relationship, cont.

- 1977 – The “Master Agreement”

→ Township and City boards and staff negotiated and entered into a new contract, which is still in effect today, for the City’s provision of water and sewer services to the Township. Under the Master Agreement:

- The 1977 contract provides for a 35-year term (expiring July 25, 2012), but specifically states that “in no event shall this contract be terminated upon expiration unless there be other adequate sources of water supply or sewage treatment available to the [Township] or that can be feasibly developed or purchased.”

(The Township has no other feasible alternative to develop or purchase its own bulk water supply and sewage treatment services; so the 1977 Master Agreement, by its own terms, did not terminate as scheduled in 2012 and is still in effect. The City disputes this, and claims the Master Agreement has terminated; this is a subject of ongoing litigation.)

History of the Relationship, cont.

- 1977 – The “Master Agreement”
 - Under the Master Agreement:
 - The City ***may not*** unilaterally increase or decrease water and sewer rates.
 - Any increase or decrease in the rate charged to the Township must be based on a “proportionate demonstrable increase or decrease” in the City’s “cost of performance” under the contract, and “shall not include increased capitalization” of the City’s system. (The “cost of performance” language indicates that the City provides water and sewer services to the Township on a wholesale basis.)
 - The 1969 contract’s provisions for a 5% late charge and 6% annual interest were eliminated. The 1977 Master Agreement contained no provisions for late fees or interest.

History of the Relationship, cont.

- 1980s – A New Rate Formula

→ Early 1980s:

- The City announced rate increases to the Township.
- The Township requested that the City provide justification for the rate increases, per the 1977 Master Agreement (rate increases were required to be proportionate and demonstrable).
- After a series of meetings with no progress being made on justifying the increases, the Township declined to pay the rate increases.

History of the Relationship, cont.

- 1980s – A New Rate Formula

→ 1987:

- Township advisors developed and proposed a rate formula for use by the City and Township, in order to standardize rate increases or decreases and to cut down on back-and-forth fighting between the two entities over whether rate increases were justified under the 1977 Master Agreement.
- The proposed rate formula made use of a model for rate development according to the American Water Works Association Manual of Water Supply Practices.
- The proposed rate formula utilized actual past volumes of water produced by the City and used by both entities, and sewage treated by the City and collected by both entities, to arrive at each year's new rate charged by the City to the Township for water and sewer services. Then at the end of each year, a reconciliation for actual use and expenditures would occur.

History of the Relationship, cont.

- 1980s – A New Rate Formula

→ 1987:

- The City and Township negotiated the new formula and adopted it as an amendment to the 1977 Master Agreement.
- As with the fixed rate set by the 1977 Master Agreement, the new rate formula resulted in a wholesale rate charged to the Township for water and sewer (*i.e.*, the bulk rate charged to the Township for re-sale to the Township's retail customers was less than the rate charged by the City to its own retail customers).
- The 1987 rate formula amendment was renewed by the City and Township (with some minor amendments over the years) on several occasions through 2012, when the City declined to further extend it.

Where Are We Now?

- 2012 – City Declines to Renew the Rate Formula Amendment
 - In 2012 officials from the City and Township had discussions regarding renewing the rate formula amendment prior to its June 30, 2012 expiration.
 - City Engineer Rich Sullenger said on several occasions: “The rate formula is a good formula; it just needs a little tweaking.”
 - Regardless of the City Engineer’s opinion, the City declined to further renew the rate formula amendment, and it expired on June 30, 2012.
 - Expiration of the rate formula amendment leaves us with the original rate modification provisions of the 1977 Master Agreement, which is still in effect: any increase or decrease in rates must be based on a proportionate demonstrable increase or decrease in the City’s cost of providing water and sewer services to the Township.
 - ***What changed for the City?***

What Changed for the City?

- After several decades of City councils, managers, engineers, and staff agreeing with the implementation and renewal of the standardized rate formula and the Township's payment of a wholesale rate, two things changed for the City in 2012:
 1. Discrepancies in the City's reported total volumes of produced water and treated sewage showed that the Township was being massively overcharged by the City;
 2. The City's Gosling Czubak study on its own water and sewer rates made it clear that the City was in dire need of much more money for repair and replacement of the City's aging water and sewer systems.

1: The City's Under-Reported Water and Sewer Volumes

- One of the inputs in the annual rate formula calculation was the total volume of water produced at the City's water plant, and the total amount of sewage treated at the City's sewage treatment plant.
 - Very generally, as the Township's bulk-metered volumes of water and sewage increased as a percentage of the City's total volumes of produced water and treated sewage, the rates charged to the Township increased (and vice versa).
- For years the City calculated its total production and treatment by simply adding up the Township's bulk-metered usage and the total usage from each individual end-user meter in the City (*i.e.*, each individual house or other serviced building).
 - For years the Township requested total production and treatment figures directly from meters at the City's plants, but the City always responded that such figures were either not available or couldn't be accurately measured.

1: The City's Under-Reported Water and Sewer Volumes

- In 2010, an *Alpena News* article reported the results of the City's independently conducted study of City water meters, which stated that the average accuracy of the City's meters was 80% or less.
 - The upshot of the inaccurate meters was that the City's annual volume figures used in the rate formula had apparently been grossly under-reported, causing the rates charged to the Township to be higher over the years than they should have been.
- The Township renewed its call for the accurate total volume figures. The City finally relented and agreed to provide them.
 - While the City Engineer's office continued to stall on producing the figures, a request was made to the City Clerk, who promptly provided the information.

1: The City's Under-Reported Water and Sewer Volumes

- The Township analyzed the newly provided accurate total volume figures from the City for the years 2005-2011, and it became readily apparent that during those years only, ***the Township had been overcharged \$1,717,350.22 by the City.***
 - This overcharge came straight out of the pockets of Township ratepayers, and was the direct result of the City's under-reporting of its total volume figures over the years.
 - The overcharge resulted in an undue subsidy of the City's water and sewer systems by Township ratepayers.
 - The Township has sued the City for recovery of this \$1.7million+, and other yet uncalculated amounts from other years.

1: The City's Under-Reported Water and Sewer Volumes

- The effect of the City's under-reported volume figures was that the Township and its ratepayers were paying for every drop of water line loss and every drop of sewer infiltration in the Township's system, while water line loss and sewer infiltration in the City were improperly kept out of the equation.
- Also, from the Township's analysis of the newly provided total volume figures, it became clear that (1) the City's water line loss was greater than the Township's; and (2) the City has a massive sewer infiltration problem. Both further exacerbated the under-reporting.
 - At the City's November 5, 2015 informational session, the City Engineer stated that the City has a half percent (0.5%) rate of water line loss in its system. That statement is simply not credible. A 10% to 15% water line loss is generally considered indicative of a tight water system, and the City's water system is known to be aged and in need of millions of dollars in repairs and upgrades.

1: The City's Under-Reported Water and Sewer Volumes

- Why were the grossly under-reported total volume figures now a problem for the City?
 - City staff realized, now that the under-reporting was known, that the true total volume figures would need to be used going forward in calculating rates charged to the Township under the rate formula amendment.
 - Using the true total volume figures would blow a large hole in the City's water and sewer budgets, as the overcharge to the Township and the undue subsidy of the City's systems by Township ratepayers would no longer occur.
 - The City realized it would need a different fee arrangement with the Township if the City was going to continue to make Township ratepayers unduly subsidize the City's systems.
- ***What else changed for the City?***

2: The City is in Dire Need of Money for Water and Sewer

- The City commissioned a rate study by Gosling Czubak, which was completed in 2013. The study made two things very clear:
 - For decades the City's staff and council artificially kept its in-City retail, end-user water and sewer rates far too low to keep up with system maintenance needs and the ever-increasing costs of operation over time.
 - City staff and council have admitted that they enjoyed giving their resident end-users some of the lowest water and sewer rates in the state for many years, effectively kicking the can down the road.
 - The City's water and sewer systems are severely outdated and in need of extensive repairs and maintenance – repairs and maintenance that had been unwisely deferred in order to give City residents artificially low rates.
 - The Gosling Czubak study reported that the City would need ***\$3.6million of additional capital each year*** just to meet maintenance and repair needs.

2: The City is in Dire Need of Money for Water and Sewer

- The portions of the City's system most in need of maintenance and replacement are not the plants and the mains that provide service to the Township.
- It is the City's local water distribution and sewer systems (*i.e.*, to individual houses and other serviced buildings in the City) that are in dire need of ongoing repair and upgrades. These are portions of the City's system that have nothing to do with servicing the Township (which in turn has its own local distribution and collection systems to maintain).

2: The City is in Dire Need of Money for Water and Sewer

- Gosling Czubak, not surprisingly, told the City that after several decades of artificially low in-City retail rates, the City's systems could not be maintained without substantial retail rate increases. The Alpena City Council refused to follow its consultant's advice, and sent City staff back to Gosling Czubak to develop a "Plan B."
- Instead of imposing a much needed substantial increase of in-City retail rates, the City staff's "Plan B" was to water down the increase for in-City retail rates to a modest 5% in 2014 and 5% in 2015.
- But since those increases were nowhere near what was needed for a sustainable in-City rate increase, "Plan B" proposed to balance the City's water and sewer budget on the backs of Township ratepayers, ***by unilaterally imposing a 61% increase in Township wholesale rates.***

The City's "Unified System" Proposal

- Faced with the need to capture more revenue from Township ratepayers to meet its own need for deferred maintenance and replacement of its decaying infrastructure, in early 2014 the City proposed a “unified” water and sewer system between the two entities, and threatened the Township with the 61% wholesale rate increase if the Township would not agree to the “unified” system.
 - Under the City’s proposal, the Township would shut down its water and sewer department and the City would have operational control over both entities’ systems.
 - Both systems would be operated by the City’s longtime water/sewer contractor. The City would handle all billing and administration for the two systems.
 - Both Township and City end-user customers would pay the same rates for water and sewer.

The City's "Unified System" Proposal

- Why was the City's unified system proposal immediately unacceptable to the Township? Under the City's proposal:
 - The City would have the ability to arbitrarily set rates without the oversight of the Township's elected officials.
 - The City would conduct all maintenance, billing, and customer service without Township oversight.
 - The Township would no longer be able to operate its own water and sewer department, and the department would have to be shut down. This would effectively lock the Township into a permanent unified system with the City, as the capital outlay required to re-boot the Township's water and sewer department would be tremendous and likely not economically feasible.

The City's "Unified System" Proposal

- Under the City's proposal:
 - The City would have the ability to determine whether and when the expansion of the system would occur; *i.e., the City would have the ability to control development or non-development in the Township*, and steer developers from prime locations in the Township toward more undesirable brownfields and other vacant lands in the City.
 - This was already attempted when the City tried to get Meijer to locate on a far less desirable site in the City on US-23 North across from the Industrial Park, instead of at the location on M-32 West in the Township that Meijer wanted and eventually built on.
 - The M-32 West corridor is the commercial and developmental future of the Alpena area. Do we want the City to be able to not properly develop the corridor with water and sewer service in order to steer developers into the City (and potentially chase developers away)?

The City's "Unified System" Proposal

- Under the City's proposal:
 - The City would be able to divert payments made by Township ratepayers that ordinarily would have been used to maintain the Township's water and sewer systems to the long-deferred maintenance problems of the City's systems.
 - The City would be able to defer needed continuing maintenance of the Township water and sewer systems – just as the City has for decades with its own system – and leave Township ratepayers with terribly compromised water and sewer systems.

The City's councilmembers are responsible at the ballot box only to City residents;

Under the City's unified system proposal, Township residents and officials would effectively have no say in the operation of water and sewer services in the Township.

The City's "Unified System" Proposal

- Therefore, the Township rejected the City's unified system proposal.

The Township's Attempts at Settlement

- As it has throughout the decades, the Township attempted to negotiate and compromise with the City throughout 2014. Meetings between the entities were scheduled and held.
- But the City would not agree to charge the Township any kind of wholesale rate that did not match the retail rate that in-City end-users pay.
- The City refused to negotiate anything else.

The Aftermath

- The City, having only slightly raised its in-City water and sewer rates for its own retail end-users in 2014 and 2015, followed through on its threat of the 61% wholesale rate increase to the Township to match the retail rates paid by City end-users, in violation of the rate provisions of the 1977 Master Agreement, still in effect.
- The Township declined to pay retail rates for the wholesale service the City provides.
- The City terminated negotiations and filed a lawsuit against the Township; the Township answered the suit and countersued the City.
- The lawsuit is pending.

Distinction Between Wholesale and Retail Customers

- As a major bulk purchaser of water and sewer services from the City, the Township is completely unlike the City's individual retail, end-use customers.
- The City provides many services to its own end-use customers that it does not provide to the Township:
 - Local distribution of water and collection of wastewater, billing, administration, operations, customer service, maintenance, metering, inspections, and others.
 - The Township built, paid for, operates, maintains, and administers its own local water and sewer systems, and the Township provides all of those same services to its own retail, end-use customers on its own.
- This is a wholesale relationship between provider (City) and customer (Township). Yet the City insists on imposing a retail rate on the Township for a lesser degree of service.

Distinction Between Wholesale and Retail Customers

- We are all familiar with the difference between wholesale and retail:
 - When you buy a gallon of milk at Walmart, you pay a retail rate to compensate the store for all of its costs in acquiring, warehousing, transporting, advertising, storing, displaying, and marketing the milk.
 - But when Walmart buys that same milk in bulk, a bulk shipment is delivered to a Walmart warehouse bay at a substantially lower wholesale price per unit.
- The same wholesale principles apply to public utilities like water, sewer, gas, and electricity.
 - For example, Alpena Power Company buys most of its electric power in bulk from Consumers Energy. Like the City with water and sewer, Consumers provides both retail service to its own end-user customers and bulk, wholesale service to other utilities like Alpena Power. Consumers charges Alpena Power a much lower wholesale rate than the retail rate it charges its individual customers, and Alpena Power in turn charges a retail rate to its own end-users.

Frequently Asked Township Rate Questions

- How does the Township use the water and sewer rates that it charges to its own retail, end-use customers?
- What are the “provisional rates” now being charged to Township customers?
- Why did the Township increase its rates during 2010-2013 when the City did not increase the rates it charged to the Township during that time?

How Does the Township Use the Rates it Charges?

- The Township pays the City for water provided and wastewater treated.
- The balance of the rates charged to customers is used to operate the Township's Department of Public Works (the water and sewer department). Funds that operate the DPW are used approximately as follows:

Wages and benefits	6 %
Office and legal	3 %
Capital improvement	2 %
<u>Operation and maintenance</u>	<u>89 %</u>
TOTAL	100 %

What are the “Provisional Rates” Now Being Charged?

- In May 2014, the City raised the rates it charges to the Township to retail levels, and raised rates again in 2015 to match the rates the City charges to its own retail, end-use customers.
- These new rates were not established in accordance with the 1977 Master Agreement, and the Township has refused to pay the increases. The Township is challenging the legality of the increases in court.
- The City is nonetheless billing the rate increases to the Township, together with large “ready-to-serve” fees and late penalties of interest upon interest.

What are the “Provisional Rates” Now Being Charged?

- To err on the side of prudence and guard against a worst-case scenario, the Township is passing the City’s rate increases, ready-to-serve charges, and late charges on to the Township’s customers through the “Provisional Rates.”
- Amounts collected as provisional rates are placed in a separate Township account.
- If the Township is successful in its litigation, or if a settlement is reached with the City, funds remaining from the Provisional Rates after payment of associated costs will be returned to the Township’s customers.

Why Did the Township Increase its Rates during 2010-2013 When the City Did Not Increase its Rates Charged to the Township During that Time?

- The rates the City charges the Township are only one component of the rates the Township charges to its own retail, end-use customers.
- For each of these years, the cost of operating the Township's system increased, just as the cost of everything increases over time.
- In addition to day-to-day cost increases, the Township makes an ongoing effort to identify problems and perform system maintenance and improvement. (The Township is not deferring maintenance to keep its rates artificially low as the City did for decades.)
- The Township does not make a "profit" on water/sewer operations.

Thank you for your attendance and concern!

- Attached information:

- Copy of letter dated March 27, 2012 from the Township's attorney (Jim Florip) to the City's attorney (Bill Pfeifer), outlining the Township's positions following discovery of the City's under-reporting of total volume figures.

- Additional inquiries:

Marie Twite, Alpena Township Supervisor: (989) 356-4024

Jerry Bleau, Alpena Township DPW Director: (989) 356-2851

Appendix A – Recent History of Alpena Township Rates

Per 1000 gallons:	Effective:					
	2010	2011	2012	2013	2014	2015
Water (regular)	\$ 5.48	\$ 6.71	\$ 6.93	\$ 6.93	\$ 7.54	\$ 7.54
Sewer (regular)	5.92	6.60	7.19	7.19	7.88	7.88
Water (provisional)					2.10	4.20
Sewer (provisional)					2.09	4.18
TOTAL REGULAR	\$ 11.40	\$ 13.31	\$ 14.12	\$ 14.12	\$ 15.42	\$ 15.42
TOTAL PROVISIONAL					\$ 4.19	\$ 8.38

Appendix B – Analysis of Township DPW Funding

For each 1000 gallons of service,

Current regular Township rates are:	\$ 7.54 (water)
	<u>7.88 (sewer)</u>
TOTAL:	\$ 15.42

Township currently paying City:	2.90 ⁶ (water)
	<u>3.47⁵ (sewer)</u>
DIFFERENCE:	\$ 9.04

- Township operates its water and sewer department on \$9.04 per every 1000 gallons of service.
- City is now attempting to run its water and sewer systems on \$10.30 per every 1000 gallons of service, with greater economies of scale than the Township has.
 - City's Gosling Czubak study revealed that the City ought to be charging its retail customers \$21.54 per every 1000 gallons (\$12.00 for water; \$9.54 for sewer) in order to keep up with all capital improvement needs.

Appendix C – Township DPW General Budgeting

Township operates its water and sewer department on \$9.04 per every 1000 gallons of service (combined water and sewer).

WAGES & BENEFITS (5 employees)	\$ 0.51	6 %
OFFICE & LEGAL (Professional services, testing, postage, billing, computers, etc.)	\$ 0.26	3 %
CAPITAL IMPROVEMENT (Savings; 10% budget reserve maintained)	\$ 0.20	2 %
OPERATIONS & MAINTENANCE (Roughly divided 60% water and 40% sewer)	\$ 8.06	89 %
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TOTALS	\$ 9.04	100%

Appendix D – Development of Provisional Rates

- When the City started threatening the Township with a unilateral wholesale rate increase in early 2014, Township rates were as follows:

Water	\$ 6.93
<u>Sewer</u>	<u>7.19</u>
TOTAL	\$ 14.12

- Not knowing exactly what the City's billed rate increase would be, Township officials thought it prudent to enact a roughly 30% provisional rate increase, effective in 2014. Provisional rates effective in 2014 were:

Provisional water	\$ 2.10
<u>Provisional sewer</u>	<u>2.09</u>
TOTAL	\$ 4.19

Appendix D – Development of Provisional Rates

- As it turned out, the City's rates billed to the Township increased 61% over two years.
- Starting with the City's first rate increase in 2014, the Township continued paying the City the previous rates, believing the City's increases to be non-compliant with the 1977 Master Agreement, and otherwise illegal.
- The City began charging the Township 6% interest (***compounding quarterly***) on any unpaid, billed amount. This equates to an interest charge of **26.2% *in the first year***. The 1977 Master Agreement does not provide for late fees or interest.
- The City also began charging the Township massive ready-to-serve fees, which also were not provided for in the 1977 Master Agreement.

Appendix D – Development of Provisional Rates

- In 2015, after review of the rates actually being charged by the City, and review of all the “extras” being charged (ready-to-serve, late fees of interest upon interest), it was deemed necessary to double the provisional rates enacted in 2015, to cover the Township’s potential “worst-case” scenario.

	2014	2015
Provisional water	\$ 2.10	\$ 4.20
Provisional sewer	2.09	4.18
TOTAL	\$ 4.19	\$ 8.38

- ***If the Township is successful in its litigation, or if a settlement is reached with the City, funds remaining from the Provisional Rates after payment of associated costs will be returned to the Township’s customers.***