

**BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN**

Application of the City of Madison, Dane County,
Wisconsin, as a Water Public Utility, for
Authority to Adjust Water Rates

Docket No. 3280-WR-114

REPLY BRIEF OF THE CITY OF MADISON

I. INTRODUCTION

The Citizens Utility Board (“CUB”) has argued in its Initial Brief that the Commission should not only disallow \$5,609,832 in construction costs, but that the Commission should “Adopt CUB’s recommendation to lower the standard 10 percent cost overage margin to 5 percent for future MWU construction projects.” (CUB Brief at 2) The City of Madison Water Utility (MWU) reasserts that the recovery of these actual construction costs should be allowed, that CUB’s recommendation about lowering the notification “standard” for MWU to 5 percent should not be followed, and that, instead, the Commission should consider opening an investigation into procedures to follow when a sewer or water utility informs the commission of cost overruns over 10 percent under Wis. Admin. Code Ch. PSC 184.04(1)(c).

II. THE ACTUAL PROJECT COSTS INCURRED BY THE UTILITY SHOULD BE RECOVERABLE IN FULL

PSC staff and CUB have both taken the position that MWU’s actual construction costs on the Well 31 project (3280-CW-117) and the Paterson Street Operations Center project (3280-CW-120) should not be recoverable in this rate case to the extent that they exceeded 10 percent of the approved project costs. (CUB Brief at 5) As support for this argument, they assert that there is a history of budgeting issues by the MWU, the projects had poor oversight, there was insufficient contingency planning, MWU did not consider modifying its plans and designs to meet the original

cost estimate, and MWU did not properly time its submissions. (CUB Brief at 5; Direct-PSC-Gysbers-14; Direct-PSC-Williams-3-9; Ex.-PSC-Williams-6; Ex.-PSC-Williams-8; Rebuttal-CUB-Singleton-8) For the reasons stated by Al Larson, Principal Engineer for MWU, MWU continues to dispute these assertions. Moreover, PSC staff and CUB's reliance upon the 10 percent notification standard as a determinative threshold of what project costs should be recovered is misplaced and misguided.

Pursuant to Wis. Admin Code Ch. PSC 184.04(1)(c), within the certificates of authority approving the projects in question (Ex.-PSC-Williams-1 and Ex.-PSC-Williams-3), the Commission ordered that if the actual cost of the approved projects exceeded the approved amount by more than 10 percent the MWU was required to promptly notify the Commission and provide a reason for the change. The Commission did not order MWU to cease the projects if actual costs exceed this threshold, nor did the Commission make a finding that any costs exceeding this approved amount should not be recoverable in the following rate case. Indeed, to argue, as PSC staff and CUB have done, that actual project costs should not be recovered because they exceeded the project estimate and approved amount by more than 10 percent does not account for the complexities of public works projects and the uncertainties of the construction market itself. Turning this margin from a notification threshold into an actual ceiling on recoverable project costs will not drive down project costs in the future nor protect the utility's rate payers. Rather, it will result in utilities significantly over estimating project costs, which in turn might lead to higher bids, seeing as the bidders on the public works projects in question will now know the actual high-end amount that can be recovered by the utility. Certainly, that is not in MWU's, nor any other water or sewer public utility's, interest.

Not only is turning the 10 percent overage amount from a notification threshold into an actual cost recovery cap misguided, but CUB and PSC staff have overlooked, or at the very least discounted, one important thing: in both projects, MWU *followed* the Commission’s order and promptly notified it of the overages in actual costs. Indeed, this fact is not in dispute and at no point have PSC staff or CUB argued that the MWU did not comply with this order. Moreover, once this notification to the Commission was made, MWU was told to proceed without further comment. As noted by Al Larson, Principal Engineer for MWU:

The Utility received no additional input or comment from the Commission or PSC staff following this notification, other than being told by Mark Williams to “proceed with the construction contracts at your discretion” and to “continue the project at your discretion” (Ex.-PSC-Williams-7). At no point was the Utility told that these costs would not be recoverable, that the Utility should consider alternative designs or scopes, or that new project authorization should be sought. Accordingly, the Utility proceeded with the projects. (Rebuttal-Madison Water Utility-Larson-3)

In addition, contrary to what has been argued by PSC staff and CUB, after discovering the cost overruns, the City did take steps to address the growing costs of the projects. Each project was delayed and the projects were each altered to secure some savings. (Rebuttal-Madison Water Utility-Larson-6, 13)

As has been identified, there were issues with project planning and estimations for these two projects—issues that the Utility has looked to address moving forward. (Rebuttal-Madison Water Utility-Larson-15; Tr. at 26) But MWU did comply with the Commission’s order to notify it of actual project costs exceeding 10 percent of the approved amount and took subsequent actions to rein in the costs, even if no direction was provided by PSC staff. The resulting costs were the project costs. As noted by Public Utility Auditor for the Commission Bridgot Gysbers, there is a “lack of clear Commission precedent regarding treatment of cost overruns”. (Direct-PSC-Gysbers-14) The Commission should not use this case, where MWU did in fact comply with the

notification standard, to establish such a standard on the recoverability of cost overruns. Accordingly, contrary to PSC staff and CUB's request, the Commission should allow the full recovery of the \$5,609,832 in project costs that exceeded 10 percent of the approved amount in this rate case.

II. REDUCING THE OVERAGE AMOUNT TO 5 PERCENT FOR MWU WILL SERVE NO PURPOSE

CUB has asked the Commission to “Adopt CUB’s recommendation to lower the standard 10 percent cost overage margin to 5 percent for future MWU construction projects.” (CUB Brief at 2) CUB’s rationale for this change to future Certificate of Authorities and Orders is that it “would not preclude MWU from recovering prudently-incurred overruns in the future; however, it would create a needed additional incentive for MWU to better manage its entire construction process.” (CUB Brief at 6) But, with the arguments of PSC staff and CUB in this rate case that the 10 percent notification threshold is actually a hard cap on recoverable construction costs, MWU is concerned that this would in fact preclude MWU from recovering additional actual project costs in the future and would not, as CUB asserts, “send a signal to the utility that it must better manage its entire construction process”. (Rebuttal-CUB-Singleton-8)

CUB supports its request by arguing that lowering the notification standard will lead to better management of projects and that it will not affect the recovery of “prudently-incurred overruns”. But, “prudently-incurred” costs are in the eye of the beholder—in this case alone, Mark Williams, a Professional Engineer with the Public Service Commission for the past three years, argued that the City’s overages should not be recovered, while Al Larson, a Principal Engineer with MWU for the last 17 years, argued that the City’s overages were recoverable project costs. As long as this notification standard is viewed as a potential barrier to the recovery of project costs, or some sort of “prudent cost” threshold, MWU will be at risk of not recovering additional actual

project costs in the future. Lowering this limit to 5% will only result in MWU making sure to overestimate its projects moving forward to ensure that its projects are fully recoverable. Lowering this limit will not cause MWU to “better manage its entire construction process” any more than submitting a change order to the City’s Board of Public Works or a budget amendment to the City Council will. The root of the problem still persists—notably, that Commission staff have no apparent authority to give any direction to utilities upon receiving notice of cost overruns. As long as water and sewer utilities are merely told to notify the Commission of overruns, but are left in the dark about PSC staff’s ideas about the future recoverability of these actual project costs, lowering, or even raising, the notification threshold will have no bearing upon how a project proceeds.

III. THE COMMISSION SHOULD CONSIDER OPENING AN INVESTIGATION INTO PROCEDURES TO FOLLOW WHEN A UTILITY INFORMS THE COMMISSION OF COST OVERRUNS OVER 10 PERCENT

As is apparent from this case, the 10 percent notification procedure, established under Wis. Admin. Code Ch. PSC 184.04(1)(c) and incorporated into the Commission’s Certificate of Authority and Order for water and sewer utility projects, has room for improvement. In the two underlying projects, MWU complied with the notification standard and was told by PSC staff to proceed or continue, and yet only in the following rate case did PSC staff express their critiques of the final project costs. Rather than being told of project concerns at a point when it could have done something about them, MWU has only been informed of these concerns in this rate case, after the projects were completed and the costs incurred. If regulated utilities aren’t given such guidance up front, and PSC staff lack the current ability to express any such concerns when notice is received by the Commission, then the notification process arguably serves little purpose. Based upon the experience of MWU and PSC staff in this rate case and the underlying projects themselves, and echoing what Bridgot Gysbers noted (that there is “a lack of clear Commission

precedent regarding treatment of overruns”) (Direct-PSC-Gysbers-14), MWU suggests that the Commission should consider opening an investigation into procedures for regulated water and sewer utilities, and Commission staff, to follow when a utility informs the commission of cost overruns over 10 percent. Additional guidance about how to handle such notifications will be beneficial to the utilities, their ratepayers and PSC staff, and hopefully avoid future disputes about the recovery of post-project costs in rate cases.

IV. CONCLUSION

For the reasons set forth in this brief and in MWU’s previously filed testimony, and contrary to those argued by CUB in its brief, MWU asserts that the Commission should allow the recovery of the \$5,609,832 in construction cost overruns incurred by MWU that were disallowed by PSC staff. In addition, the Commission should not adopt CUB’s recommendation to lower the standard 10 percent cost overage margin to 5 percent for future MWU construction projects. Instead, the Commission should consider opening an investigation into procedures for regulated water and sewer utilities, and Commission staff, to follow when a utility informs the commission of cost overruns over 10 percent under Wis. Admin. Code Ch. PSC 184.04(1)(c).

Dated at Madison, Wisconsin, this 14th day of September, 2018.

City of Madison

/s/ *Doran Viste*

Doran Viste
Assistant City Attorney, City of Madison
State Bar. No. 1037829

Office of the City Attorney
210 Martin Luther King Jr. Blvd, Rm. 401
Madison, WI 53703-3345
Phone: (608) 236-4511
Fax: (608) 267-8715
e-mail: dviste@cityofmadison.com