

Agenda Date: December 18, 2003
Item Number:

Docket: UW-031671
Company Name: Tall Timber Water Systems, LLC
Staff: Jim Ward, Regulatory Analyst

Recommendation:

Dismiss the Complaint and Order Suspending the Tariff Revisions filed by Tall Timber Water Systems, LLC, in Docket UW-031671 and approve revised rates to become effective December 19, 2003.

Discussion:

On October 14, 2003, Tall Timber Water Systems, LLC, (Tall Timber or Company) filed to revise its tariff to reflect a general rate increase, restructure rate design, add ancillary charges and update its service area. That filing would have generated an additional \$97,902 (38%) annually.

On December 5, 2003, the Company filed revised rates that would instead generate an additional \$54,800 (26%) of revenue annually. The Company serves approximately 765 active customers on 79 water systems in Mason, Thurston, Pierce, Lewis and Kitsap counties. The Company received its last general rate increase in 1996.

On November 26, 2003, the Commission heard this matter. At that open meeting the Commission suspended the filing.

The Company stated it is filing to increase rates to generate additional revenue due to changes in liability insurance, electrical power, and operational costs for services provided by Utility Management Services. The Company states it has also experienced increased costs in general maintenance due to aging infrastructure and increased water quality requirements. To help offset some cost, the Company has also filed to add several ancillary charges, such as Late Payment, NSF Check, and New Account Setup charges, which are intended to recover non-water service costs from the specific customer who creates the expense.

The revised tariff revision also removes the 400 cubic feet allowance currently imbedded in the base meter charge and implements a zero allowance rate design with a revised two-block rate design. This rate design encourages conservation and ensures that low end users would only pay for the actual water used. Currently, the Company has about 268 flat rate customers and intends to meter all customers within the next several years.

In the original filing, the Commission received 31 comments opposing the rate increase, including a letter from a homeowners association consisting of 40 units. Several customers noted that the company did not provide sufficient documentation to support the rate increase. Most of the customers commented that the increase of over 30% was extremely high, especially for people living on fixed incomes. Some customers conveyed that their water quality is poor

and the pressure is low, which will not be resolved with the rate increase. Commission Staff investigated these concerns and opened three complaints that the company did not respond timely during an outage. Tall Timbers reported that its paging system failed, and the company restored water service upon receiving the outage reports. Violations were noted for late responses under WAC 480-110-315 (3). Customers were provided credits for the inconvenience.

Customers also noted that the comparison in the Company notice, regarding other water system rates, was misleading and irrelevant, and the new rates will not encourage conservation, but would be punitive to the current users. A few customers mentioned that the Company's costs are high because of poor office management, inadequate customer service, and disorganized fieldwork. Customers noted that it's unfair that the Company buys water systems for little, or nothing, then expects the ratepayers to pay for all repairs and upgrades. Another customer commented that the rate increase is unfair to the recreational user. The proposed increase would have resulted in an average increase of \$10.50 per month to each customer. The revised rates would result in reductions for usage up to 200 cubic feet and an average increase of \$5.50 per month to each customer.

Staff met with customers following the November 26, 2003, Open Meeting. The following is a report of the meeting.

Open Meeting the Day Before a Holiday – Unreasonable. Some customers were very upset that the Commission scheduled Tall Timber's proposed rate increase for consideration the day before Thanksgiving. Customers commented:

- Both the Company and the Commission had orchestrated the timing to discourage customers from appearing before the Commission and making comments.
- A meeting the day before Thanksgiving forced customers to choose between family obligations and attending the Open Meeting to express their concerns.
- A meeting during the day required some customers to take time off work to attend the meeting and make comments to the Commission.
- Customers do not consider the "bridge" telephone call-in system an effective way to participate in the Open Meeting process.
- The Commission should schedule its Open Meeting at night, near the water system.

Single-Tariff Pricing. The Company proposes to establish uniform rates, known as Single-Tariff Pricing, for all customers served on its 79 water systems. Single-Tariff Pricing distributes invested capital plant, required system upgrades and improvements, and operating costs equally across all customers within the same company. Customers who live on systems that require investment to upgrade or replace facilities, or require installation of expensive filtration or treatment, prefer Single-Tariff Pricing because they pay lower rates since Single-Tariff Pricing distributes some of the required costs spent on their system to customers on other systems. Customers who live on systems that are new, well designed, well constructed, well maintained, and have a good water source do not like Single-Tariff Pricing because they pay higher rates than they would on a stand-alone basis.

There is an important exception to Single-Tariff Pricing. It has been Commission policy that Customers who want utility plant that exceeds government requirements pay for the plant on a stand-alone system basis. Examples of voluntary upgrades include; fire flow when not required by the Fire Marshall, backup generators that are not required by the Department of Health (DOH), and treatment and filtration that are not required by DOH. An example of treatment and filtration in excess of government requirements is the water treatment needed to remove iron and manganese. The U.S. Environmental Protection Agency classifies iron and manganese as secondary contaminants. Exceeding a Maximum Contaminant Level for a secondary contaminant requires a company to survey its customers to determine if the customers are willing to pay additional rates to correct the problem. Customers of a stand-alone system may ask the water company to install a treatment or filtration system, however, because there is no regulatory requirement to treat and filter, the cost associated with the treatment and filtration would not qualify as common costs to spread to all customers on a company wide basis. Instead, the costs would stay with the individual system.

Example: Customers on the Cedar Shores water system (owned by Tall Timber) voted to pay an additional \$13.25 per month to pay for treatment and filtration for iron and manganese on their water system. On May 30, 2001, the Commission approved the surcharge to apply to only Cedar Shores customers.

Customers strongly objected to the Commission imposing higher rates on them to pay for someone else's water system. Customers also strongly objected to the Commission allowing Tall Timber to continue purchasing run-down, nonregulated water systems that require existing customers to pay ever-increasing rates to improve and upgrade. (See the following section on purchase of nonregulated water systems.)

The Commission has consistently used Single-Tariff Pricing since the early 1990s. The U.S. Environmental Protection Agency and the National Association of Regulatory Utility Commissioners issued a joint publication titled "Consolidated Water Rates: Issues and Practices in Single-Tariff Pricing" in September 1999. The report states that only ten states regulate more than ten multi-system utilities and nine (including Washington) have approved Single-Tariff Pricing.

In Docket UW-001866, the Company, in response to a DOH order, requested recovery of the capital improvements it made to 12 of its 57 water systems. If customers on each system paid only for the costs associated with their system, the monthly cost per customer would have varied from \$8.41 to \$47.08. The Commission's use of Single-Tariff Pricing established monthly rates of \$5.60 for all customers.

Water System	Monthly Surcharge	
	Stand-Alone	Single-Tariff Pricing
Violet Meadows Estates 1 – 6	\$17.21	\$5.60

Violet Meadows A, B, C, D	\$20.98	\$5.60
Rainbow Lake Water	\$8.41	\$5.60
Sandra Avenue Water System	\$47.08	\$5.60
45 Other Water Systems	\$00.00	\$5.60

Staff supports Single-Tariff Pricing and recommends the Commission use Single-Tariff Pricing to set rates in this docket. Under Single-Tariff Pricing, some customers pay more and some customers pay less than rates set on a stand-alone basis. All systems will require capital improvements sooner or later. Single-Tariff Pricing distributes the risk of the individual water customer in much the same way as an insurance pool.

Purchase of Nonregulated Water Systems. Customers want the Commission to prohibit Tall Timber from purchasing nonregulated water systems because with Single-Tariff Pricing, the existing customers contribute to the cost to upgrade the new water system and bring it into compliance with water quality and quantity requirements. Alternatively, customers want the Commission to stop using Single-Tariff Pricing, which will force customers on newly acquired systems to pay the costs associated with bringing their own system into compliance. Stand-alone pricing would also require customers of current systems to carry the risk of having to pay for major repairs or replacements themselves, which, especially with smaller systems, cause severe hardship on ratepayers.

Staff can find no specific statutory limitations that would prevent a regulated water company from purchasing a nonregulated water system. Additionally, as noted below, the DOH has a policy of encouraging consolidation of stand alone water systems into satellite systems to offer managerial, technical and financial capacity. Staff believes that the Commission may find, after hearing, that it is in the public interest to require a company to stop purchasing nonregulated water systems for a specific reason and time.

The Governor's Office, the Department of Health, and the Commission all share strategic goals and strategies designed to encourage consolidation in the water industry. Consolidation leads to shared economies and lower average costs overall.

Fire Flow. Fire flow is the exclusive jurisdiction of the local Fire Marshal. If the Fire Marshal requires a system to provide fire flow, Staff would recommend that the Commission treat costs incurred to upgrade the system as common costs in setting rates using Single-Tariff Pricing. However, if customers choose, by majority vote, to voluntarily upgrade their system, Staff would recommend the Commission treat costs incurred as system specific costs, not common or company-wide costs. Customers with concerns regarding fire flow were advised to contact their local Fire Marshal.

Water Quality. The Department of Health (DOH) regulates water quality. As part of its regulatory function, DOH enforces compliance with Safe Drinking Water Act (SDWA) requirements.

SDWA requirements include:

Primary Contaminants (lead, copper, coliform, etc.) SDWA established Maximum Contaminant Levels for primary contaminants, which, if exceeded, require water companies to treat the water. Treatment or filtration costs incurred to comply with these government requirements are treated as common costs in setting rates using Single-Tariff Pricing.

Secondary Contaminants (iron, manganese, taste, odor, turbidity, etc.) Although the SDWA sets Maximum Contaminant Levels for secondary contaminants, such as iron and manganese, it does not require treatment or filtration unless customers choose to pay the costs. Since treatment and filtration of secondary contaminants are voluntary on the part of customers, costs incurred on a single system are not treated as common costs in setting rates when using Single-Tariff Pricing. Customers on a system that has voted to upgrade beyond DOH requirements bear the costs incurred. For example, (see previous example regarding Cedar Shores treatment costs.) customers on the Cedar Shores water system voted to install iron and manganese treatment at a cost of \$13.25 per customer per month. Customers on other water systems do not pay any of the treatment costs of Cedar Shores.

Department of Health also provides regulations on system design and construction standards, pressure requirements, storage and usage requirements, etc. In our meeting, customers expressed concerns regarding:

- Distribution pipes laid down the middle of a road, preventing the road from being paved.
- Low water pressure.
- Water outages.

Customers with concerns regarding water quantity were advised to contact the Department of Health at 1-800-521-0323.

Affiliated Companies. In addition to owning Tall Timber, Mr. Harrington owns all, or portions of the following regulated water companies:

- H & R Waterworks, Inc.
- Meadows Water System, LLC
- Quail Run Water Company
- Timberline Village Water Company, Inc.
- WACOWA (The Water Company of Washington, LLC)
- Mr. Harrington also owns Utility Management Services (UMS), which is nonregulated.

Because all of these companies share common ownership, they are affiliates. Staff reviews

charges from an affiliated interest to a regulated company to ensure that the affiliated interest charges a regulated company no more than the cost incurred by the affiliated interest.

UMS is a Satellite Management Agency (SMA) licensed by the Department of Health to manage and operate community water systems by providing meter reading, testing, routine maintenance, and billing services, and addressing customer concerns and complaints. The Commission does not regulate UMS. UMS provides SMA services to the six regulated water companies in addition to providing SMA services to non-regulated water companies, construction services to affiliated and non-affiliated water companies, construction services to regulated and non-regulated water companies, and construction services to non-water companies.

In a previous case filed by Timberline Village Water Company, Inc., Docket UW-030410, the Commission adopted a Settlement Agreement between Staff and Timberline Village Water Company, Inc., which allocated UMS costs to both regulated and nonregulated activities. The Settlement Agreement also provides the method for the allocation of costs for officer salary, property and liability insurance, and SMA services that are provided through UMS. A brief description of the methods is set out below. Those costs are excluded from Tall Timber accounts.

Allocation of Officer Salary. Mr. Harrington is the owner and president of six regulated water companies and owner and president of UMS. Commission Staff determined an appropriate salary for an officer of all six regulated water companies, including benefits and taxes and then allocated an amount to each water company on a proportional basis, based upon the number of customers served by each company.

Allocation of Insurance Costs. UMS's insurance policy includes coverage for Automobiles, Property, and Liability (General and Umbrella). Under the Settlement Agreement, the parties agreed that the automobile insurance premium would be included in UMS' general and administrative costs. A portion of these costs was removed as unrelated to the regulated companies. The remainder was allocated among regulated and non-regulated services as described below.

The parties also agreed that a portion of the property insurance premium would be allocated to UMS using a ratio of UMS net assets to total net assets (3.44%). This portion is included in UMS' general and administrative costs, similar to the automobile insurance premium. The remainder is allocated directly to the affiliated regulated water companies based on the number of customers served by each company. The liability insurance premium is allocated directly to the six affiliated regulated water companies, UMS' non-regulated services and other services based on the number of customers.

Allocation of UMS Costs. Commission Staff and Timberline Village agreed to an allocation method that allocates UMS' costs among the six, affiliated regulated water companies that UMS provides SMA and construction services, the non-regulated water

companies for which UMS provides SMA and construction services, and the other services UMS provides. The allocation method is based upon four separate work functions and allocation factors using direct hours from timesheets as well as standardized and estimated times to allocate costs.

No Independent Audit. Customers want the Commission to require an independent audit of Tall Timber. They were not satisfied with Staff’s explanation that the Commission hired Staff to perform that independent audit. Customers do not perceive Staff as being independent of the Commissioners and expressed concerns that Staff would simply “go through the motions” and make a recommendation that caused the least amount of problems for the agency. We also note that expenses the Company incurred for an independent audit would be recoverable in rates.

Also discussed at the meeting were the commission compliant process and the following miscellaneous issues;

- Why do metered customers receive a “flat rate” bill?
- Questions about the current treatment surcharge.
- Confusion about how many systems the Company owns.
- Customers did not receive a notice of proposed increase from the Company.
- Concerns regarding the Company failing to maintain grounds around water company property, which prevented the electric company from reading a meter.
- Why the Company did not attend the Commission’s Open Meeting.

On December 4, 2003, Staff sent notice to customers that the Commission would consider this matter at the December 18, 2003, Open Meeting. The notice consisted of a cover letter (attached) a draft version of this memorandum, the results of operation statement (attached) and a comparison of the current charges to the revised charges (attached).

The current, original proposed, and revised rates are provided below:

<u>Monthly Rate</u>	<u>Current</u>	<u>Proposed</u>	<u>Original</u> <u>Revised</u>
Flat Rate Service	\$ 32.00	\$ 42.50	\$ 37.50
Metered Rate Service	\$ 28.50	\$ 30.47	\$ 26.00
Per 1 cubic foot up to 766 cu ft	Included	\$ 0.0157	\$ 0.0100
Per 1 cubic foot 766 to 5,000 cu. ft.	\$ 0.01	\$ 0.0195	\$ 0.0165
Per 1 cubic foot over 5,000 cu. ft.	\$ 0.01	\$ 0.0225	\$ 0.0165
		<u>Original</u>	
<u>Ancillary Charges:</u>	<u>Current</u>	<u>Proposed</u>	<u>Revised</u>
Late Payment Charge	N/A	\$ 3.50	\$ 3.50
New Account Setup Charge	N/A	\$ 15.00	\$ 15.00
NSF Check Charge	N/A	\$ 15.00	\$ 15.00
Ready To Serve Charge	\$ 8.52	\$ 9.27	\$ 9.27
State Public Utility Tax	N/A	5.029%	5.029%

Additionally, all customers pay a basic treatment surcharge of \$5.60 per month that will expire on or before December 31, 2006, and the customers of Cedar Shores water system located in Thurston County pay an additional \$13.25 per month for water treatment that will expire in 2011.

The attached exhibit (attachment 2) shows the effect of the revised rates at different usage amounts. The combined effect of changing to a “zero usage” base rate and the revised rate design results in rate decreases for usage up to 200 cubic feet and increases for usage above 200 cubic feet. As usage increases, the percentage of increase also increases.

Conclusion

Staff’s review of the Company’s books and records show the Company has now demonstrated that it requires additional revenue and Staff believes the revised rates are fair, just, and reasonable. Therefore, Staff recommends that the Commission Dismiss the Complaint and Order Suspending the Tariff Revisions filed by Tall Timber Water Systems, LLC, in Docket UW-031671 and approve revised rates to become effective December 19, 2003.