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1 P R O C E E D I N G S

2 JUDGE SCHAER: We're back on the record.

3 This is the second day of cross examination
4 hearings in Rainier View Water Company, Inc., Docket No.
5 UW-010877. Last evening we had just concluded with the
6 presentation of Ms. Ingram's exhibits, which were
7 entered into the record, and Ms. Tennyson had
8 distributed some cross exhibits.

9 And I believe you passed out another one this
10 morning?

11 MS. TENNYSON: That's correct. I provided a
12 copy to Mr. Finnigan, and Ms. Ingram yesterday evening.

13 JUDGE SCHAER: What I have before me I am going
14 to mark as Exhibit 49 for identification. And its
15 heading is Rainier View Water Company, Inc. Financial
16 Report, December 31st, 2000.

17 So, Mr. Finnigan, why don't you go ahead. Had
18 you already tendered the witness?

19 MR. FINNIGAN: I had at the close of yesterday.

20 JUDGE SCHAER: I couldn't remember if you had
21 asked her name and those things or not.

22 Ms. Tennyson, go ahead.

23 MS. TENNYSON: Thank you.

24

25 CROSS EXAMINATION

0214

1 BY MS. TENNYSON:

2 Q Good morning, Ms. Ingram.

3 A Good morning.

4 Q Can you describe what training you had in the
5 preparation of Federal income taxes for the corporation?

6 A I have a bachelor's of arts degree in
7 accounting. And as part of that, you are trained on
8 Federal income taxes for corporations, partnerships,
9 individuals, et cetera.

10 Q Have you ever worked in the public accounting
11 field?

12 A No.

13 Q And you have worked for a public utility
14 district, correct?

15 A Correct.

16 Q PUD doesn't pay income taxes, does it?

17 A No.

18 MS. TENNYSON: I don't know whether the
19 microphones are working. And I am having trouble
20 hearing.

21 JUDGE SCHAER: Try that.

22 Q BY MS. TENNYSON: Now, I would like to refer to
23 your testimony at this point. And right now I would
24 like to look at page 3, line 26. I want to just clarify
25 a couple of things.

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1 A (Complies.)

2 Q Now, at page 3, line 26 of your testimony, you
3 say, "Subchapter S corporations distribute its net
4 earnings to each shareholder."

5 Do you mean distribute in the same sense as the
6 other witnesses for the Company?

7 A I am not sure what reference to the other
8 witnesses -- I guess maybe if you could direct me to
9 where they say that.

10 Q Well, I guess my question is, doesn't a sub S
11 corporation report the income to the shareholder?

12 A That's correct. That's what I meant by
13 "distribute."

14 Q And you use the term net earnings when
15 discussing an S corporation at page 3, when immediately
16 after that you use net income when you discuss the
17 partnership. Were you meaning to use those terms
18 synonymously?

19 A Correct.

20 Q It's my understanding the term net earnings --
21 we usually use that for self-employment income. So I
22 will try to use the term net income in our
23 conversations.

24 A That's fine.

25 Q Still on page 3, you attribute to Mr. Kermode a

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1 basis for his statement. You state that Rainier View's
2 election of subchapter S corporation is the basis for
3 his statement. Referring to page 3, line 24 of your
4 testimony.

5 A That's correct.

6 Q And then you go on to say you attribute the
7 basis -- you don't know for a fact what the basis for
8 his statement was, do you?

9 A I made that assumption based upon the text in
10 this testimony where he cites that since the corporation
11 is a subchapter S, there should be no income tax.

12 Q Going on to page -- or page 4, line 21 of your
13 testimony, you quote Mr. Kermode as saying, "The
14 Commission has not issued any order or decision
15 approving rates for an S corporation that included the
16 recovery of income taxes." Do you see that?

17 A Yes.

18 Q Now, in the quote that you refer to,
19 Mr. Kermode was, in fact, discussing imputed income
20 taxes, wasn't he?

21 A I would have to look at his testimony.

22 Q Okay. I would like to refer you to Mr.
23 Kermode's testimony at that point that you are referring
24 to. And you refer to his testimony at DKT-1, lines 24
25 and 25, page 15.

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1 JUDGE SCHAER: You have to give me the page
2 number before the line number.

3 MS. TENNYSON: Sure. Page 15.

4 THE WITNESS: In his testimony he talks about
5 "The Company," meaning Rainier View, "has filed tariffs
6 that include recovery of imputed income tax."

7 However, his statement prior to that says, "The
8 Commission has not issued any order or decision
9 approving rates for an S corporation that included
10 recovery of income tax." So what I read into that --

11 Q BY MS. TENNYSON: I haven't asked a question,
12 Ms. Ingram.

13 MR. FINNIGAN: I thought you had.

14 MS. TENNYSON: I was asking her to refer to the
15 testimony, and I have a specific question I would like
16 her to answer relating to the testimony.

17 Q BY MS. TENNYSON: What I would like you to do
18 is read the question that starts on line 21 of
19 Mr. Kermode's testimony at page 15.

20 A "Before you go further, clarification may be
21 necessary relative to the income tax issue. Has the
22 WUTC approved Rainer View Water imputing income tax in
23 its rates?"

24 Q Thank you. I would like you -- do you have
25 Mr. Fisher's exhibit, or copies of the Company's Results

0218

1 of Operations?

2 A I don't believe I do.

3 JUDGE SCHAER: Mr. Finnigan, do you have a copy
4 that can be made available?

5 MR. FINNIGAN: Which one are you referring to?

6 MS. TENNYSON: DFT, the Result of Operations.
7 What I had in my notes as DF-21.

8 MR. FINNIGAN: DF-21, that's why I asked.

9 MS. TENNYSON: DF-22 would be fine.

10 THE WITNESS: (Reading document.)

11 Q BY MS. TENNYSON: I have asked you to refer to
12 Exhibit DF-22, and Mr. Fisher's exhibits. And that's
13 the Company's Results of Operations; is that right?

14 A That's correct.

15 Q You testified quite a bit about the CIAC
16 gross-up tax. And my question is, the CIAC gross-up tax
17 is not in the Company's results of operations; is that
18 true?

19 A That's correct.

20 Q Is the CIAC gross-up tax ever included in the
21 results of operations as an expense?

22 A Typically the CIAC is part of rate base. It
23 becomes a result of adding rate base contributors, and
24 therefore, it doesn't come onto the income -- the
25 results of operations.

0219

1 Q But the tax also doesn't show up in -- the tax
2 on the CIAC also doesn't show up in the results of
3 operations?

4 A Correct.

5 Q Wouldn't it be appropriate to describe this tax
6 as a flow-through tax?

7 A Yeah.

8 Q So it comes in, and it goes directly out to the
9 IRS, essentially?

10 A On the IRS tax return.

11 Q Right.

12 A Right.

13 Q Yes. It's not an immediate transfer, that's
14 true.

15 A Right.

16 Q To the best of your knowledge, has this
17 Commission ever approved by order Federal income tax for
18 a subchapter S corporation that included imputed income
19 taxes based on utility operating income?

20 A I can't answer that. I don't know the history
21 of all the orders that were issued by the Commission.

22 Q When the CIAC gross-up tax is paid, does the
23 shareholder now get a tax base in the contributed
24 assets?

25 A I don't follow your question.

0220

1 Q When the CIAC gross-up tax is paid --

2 A To the IRS, or from the developer, or from
3 whomever it's collected from?

4 Q Well, let's say when it's paid by the
5 developer.

6 A Okay.

7 Q Either circumstance, I think the example would
8 hold. Does the shareholder now have a tax base in the
9 contributed assets?

10 A I don't know. I haven't done an income tax
11 return for an S corporation or shareholder.

12 Q Okay. You answered one of my later questions,
13 too, so thank you.

14 In your testimony that starts at page 5, line
15 8, you detail how the gross-up percentage is calculated
16 in the Rainier View tariff. Did you recognize any
17 future tax benefits to the owner in this calculation?

18 MR. FINNIGAN: Excuse me. I need to catch up
19 with you. You are where?

20 MS. TENNYSON: Page 5, line 8.

21 MR. FINNIGAN: And the question was?

22 MS. TENNYSON: That she talked about how the
23 gross-up percentage is calculated. That's where she
24 starts talking about it.

25 Q BY MS. TENNYSON: My question is, did you

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1 recognize any future tax benefits to the owner when you
2 make this calculation?

3 A In the response to this question, the question
4 in my testimony at line 8, "Is this common practice for
5 similar charges," all I was trying to indicate was to
6 give an example of what occurs when CIAC is collected on
7 a charge and a tariff, or in a contract.

8 Q Right. And my question was, beginning at line
9 8, you go here to great lengths to demonstrate this.
10 You go on for a couple of pages on this demonstration of
11 the gross-up formula.

12 Is your answer that you didn't recognize any
13 future tax benefits to the owner?

14 A No. I was simply showing analysis of what
15 occurs on -- occurs when the CIAC tax is collected.

16 Q To your knowledge, do the income taxes provided
17 for in corporation rates provide the owner or the
18 utility any future tax benefits?

19 A Potentially. It all depends on, in this case,
20 how an individual's tax planning is performed.

21 Q At page 6 of your testimony you use this
22 hypothetical example of how the gross-up tax is
23 calculated, and you use a 15 percent straight tax rate?

24 A Correct.

25 Q Do you know at what rate the Company actually

0222

1 collects the CIAC tax?

2 A I don't know. It appears from their tariff as
3 though they collect it based upon -- the tariff states
4 in Exhibit HMI-2 -- I am not sure what the exhibit
5 number is on that.

6 MR. FINNIGAN: For the record, it's Exhibit 46.

7 THE WITNESS: Exhibit 46, which is the first
8 Revised Sheet No. 33, canceling the original sheet,
9 No. 33. Schedule No. 3 on Service Connection Charges,
10 the Company has in their tariff that income tax will be
11 recovered at whatever the Federal income tax rate is. I
12 am not sure what rate they deduct.

13 Q Would you accept, subject to check -- and
14 I will give you a couple of references -- that in the
15 contracts in Exhibit DF-14, there's an example at page
16 286 through 289 that includes the rate of 44.9 percent,
17 and at 437 there's one of 65.6 percent?

18 A Subject to check, I will accept that.

19 MR. FINNIGAN: Can I inquire about the subject
20 to check? Is that meant by you to be illustrative, or
21 definitive in asking her to check?

22 MS. TENNYSON: I am asking just so -- what I am
23 looking at, these are two of the rates the Company has
24 used in the past. It may not be the current rate.

25 MR. FINNIGAN: Fine. I don't have any problem

0223

1 with that.

2 MS. TENNYSON: My only point was the 15 percent
3 wasn't an actual.

4 THE WITNESS: I never intended it to be. As I
5 said before, the analysis that I gave in my testimony
6 was simply an example.

7 Q BY MS. TENNYSON: Certainly. On page 7 of your
8 testimony, starting on line 9, you quote from a
9 financial accounting text about the purpose of the
10 addition of the subchapter S corporate form to the
11 Internal Revenue Code, as providing to a small business
12 the advantages of the corporate form of organization
13 without being subject to the possible tax disadvantages
14 of the corporation.

15 A That's correct.

16 Q Would you agree, then, there's a benefit to the
17 owner of a corporation that elects the subchapter S
18 status in choosing this form of corporate structure?

19 A I believe there's a benefit to both the
20 corporation and the owner.

21 Q And it is the owner or the shareholders that
22 makes the subchapter S election; is that correct?

23 A I believe so.

24 Q Can you -- the language that you quoted refers
25 to possible tax disadvantages of the corporation. Can

0224

1 you tell us what some of the tax disadvantages of a
2 corporation are?

3 In a corporation -- in a C corporation, the
4 income is taxed at the corporate level, which means that
5 the corporation -- the income from the corporation is
6 taxed. At that point, then, any dividends that are
7 distributed to the shareholders are taxable on their
8 personal income tax returns. So in essence, on the
9 dollars that are distributed for dividends, you would
10 have a double taxation.

11 Q Do you know of any other disadvantages of the C
12 corporation form as opposed to the S?

13 A Not without doing any research.

14 Q Continuing on page 7, at line 17, you state,
15 "Rainier View passes the regulated net income to the
16 shareholders. Tax on that revenue is paid off the
17 shareholder's return."

18 A Correct.

19 Q Are you familiar with the testimony of Mr. Ault
20 and Ms. Parker in this case?

21 A Yes.

22 Q Do you recall their testimony that Rainier View
23 doesn't distribute the net income to shareholders?

24 A Again, when I said "distribute," it's as I
25 stated earlier. I meant that the income amount is

0225

1 passed through for tax purposes, not necessarily the
2 cash was transferred.

3 Q And so for Rainier View, I gather from what you
4 have described that the Company doesn't pay tax at the
5 corporate level first, but the income then is taxed at
6 the shareholder level?

7 A Correct.

8 Q Do you know if Rainier View distributes
9 anything more than the amount to pay the tax liability
10 to its shareholders? It doesn't distribute everything,
11 does it?

12 A From others' testimony, I would gather not. I
13 haven't actually seen or audited their books and
14 records, so I couldn't answer that.

15 Q If Rainier View distributes only the tax
16 portion of its net income to the shareholders, what are
17 the disadvantages of the Company? What would be the
18 disadvantages of being a C corporation?

19 A You know, I can't even get into that issue.
20 There are so many other factors that come into play when
21 you are choosing a corporate structure, I don't think
22 it's based solely on income tax.

23 Q On page 8 you make some extrapolations from
24 Mr. Kermod's testimony, and you refer to sole
25 proprietorships, partnerships, and subsidiary

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1 relationships?

2 A Correct.

3 Q Mr. Kermode does not testify about any of those
4 aspects, does he?

5 A No, he doesn't.

6 Q So these are your conclusions drawn from his
7 testimony, extrapolated from the theory that he has
8 presented?

9 A These are my conclusions to, in essence,
10 provide a different viewpoint of Mr. Kermode's
11 testimony. Mr. Kermode spends a great deal of time
12 talking about the tax implications to a subchapter S
13 corporation.

14 What I was trying to demonstrate is for tax
15 purposes, in the issue that we're looking at here today,
16 which is whether the income tax should be allowed in
17 rates, I was trying to demonstrate that for other
18 entities where the tax is not paid at the business
19 entity level, they were allowed in rates.

20 Q Do you know what the corporate form of each of
21 the companies that you referred to on page 8, the other
22 regulated utilities are?

23 A I believe that all of them are C corporations,
24 but I can't state that definitively.

25 Q I would like you, at this point, to refer to

0227

1 what's been marked as Exhibit 49.

2 A (Complies.)

3 Q The Company's financial report for 2000.

4 A Okay.

5 Q Now, you were provided with a copy of this
6 document yesterday. Have you had an opportunity to
7 review it?

8 A I have very briefly.

9 Q What I would like you to do is refer to page 7
10 of the document.

11 MR. FINNIGAN: I am going to object to any
12 questions about this document unless there's a
13 foundation laid that she has knowledge and can testify
14 about the substance of the document.

15 JUDGE SCHAER: Objection is foundation,
16 Ms. Tennyson.

17 MS. TENNYSON: I did provide a copy of it for
18 her to review. I am not going to ask her any details
19 about the calculations on the document. I just want her
20 to determine whether she agrees with a particular
21 statement made in the document relating to income tax.

22 So she has testified quite a bit about -- in
23 her testimony about subchapter S corporations, the tax
24 effects, income taxes. And there's a statement about
25 income taxes relating to Rainier View in this document,

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1 and I want to determine whether she agrees with it.

2 MR. FINNIGAN: Well, Mr. Ault was here
3 yesterday. His firm prepared this document. If there's
4 a question about a statement in this document, I mean,
5 it should have come in through Mr. Ault.

6 I cannot, because Mr. Ault is not here,
7 redirect on that issue and ask about the meaning of any
8 statement in here through this witness. So asking her
9 whether she agrees or disagrees with the statement
10 leaves me with no basis to redirect concerning what the
11 statement may mean or not mean.

12 So on that basis, I still don't believe there's
13 a foundation laid to examine on this document.

14 JUDGE SCHAER: What I think is the way we
15 should go forward, this has not been offered as an
16 exhibit --

17 MS. TENNYSON: I would like to offer --

18 JUDGE SCHAER: Let me finish, please, first,
19 Ms. Tennyson.

20 -- and it may be that this would not be
21 admitted as an exhibit, because of a foundation problem
22 for a sponsored witness. But I do think it's
23 appropriate to show information to a witness and ask
24 them if they have an -- if that is consistent with their
25 testimony, or if they have an opinion about it, the same

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1 way you could do with a textbook or something else.

2 So I am going to allow Ms. Tennyson to ask
3 questions. Of course, if your witness doesn't know the
4 answer, then she has caused herself problems because she
5 didn't ask the person who did, perhaps, know the answer.
6 But the questioning that is going on, I think, is
7 appropriate, and I will allow it to proceed.

8 Q BY MS. TENNYSON: Ms. Ingram, if you could
9 refer to page 7 of what has been marked as Exhibit 49.

10 A (Complies.)

11 Q And this statement, in particular, that's
12 headed Income Taxes on that page, I would like you to
13 read it to yourself, and then I can ask you a question
14 about it.

15 A (Reading document.)

16 Q Do you agree with that statement?

17 A This financial statement was prepared in
18 accordance with GAP, which is distinctly different than
19 regulatory accounting. In this financial statement the
20 auditors have to represent the corporate view of the
21 Company -- of the firm that we're talking about, Rainier
22 View Water.

23 In such, they can't impute anything. They
24 can't include things that may be different for other
25 types of reporting purposes; and in our case, regulatory

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1 accounting.

2 And I agree with this statement being part of
3 these financial statements. However, I don't believe
4 the statement is a good basis for rate-making theory.

5 Q The first two sentences of this are consistent
6 with your testimony, are they not?

7 A That's correct.

8 Q Can you tell us, what are some of the
9 differences? You said there's substantial differences
10 between GAP and regulatory accounting with regard to
11 corporate income taxes. Can you tell us what some of
12 those differences are?

13 A Absolutely. In GAP accounting, for an S
14 corporation, as the statement states, you don't include
15 income taxes on the financial statement, because they
16 aren't paid with a check from the Company. Instead,
17 they are -- the earnings are flown through to the
18 individual shareholders.

19 In regulatory accounting, however, a generally
20 accepted principle is that the cost causer pays, and
21 therefore, things that may not appear on the Company's
22 books and records are generally imputed or included in
23 the results of operations in one form or another,
24 whether it would be a restating or proforma adjustment.

25 Q Now, for a CIAC, a contributed plant situation,

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1 I can see where cost causer pays makes sense. The
2 developer contributing to the plant pays the tax on
3 this.

4 Are you saying that applying this concept
5 further to a regulated company, that because I buy water
6 service from a company and I give the money for that,
7 then I should pay the taxes on that money?

8 A For the purposes of setting rates, I don't see
9 a difference in tax collected from a developer, who is
10 contributing an asset, and the tax liability on income
11 that is derived from selling water.

12 The tax in either case is not paid at the
13 corporate level. It's paid off of the shareholders'
14 return. So in essence, I see them as one and the same.
15 And, therefore, yes, I believe the people who pay the
16 water rates should pay also for the income tax
17 associated therewith.

18 Q Do you know how other states treat income taxes
19 in rates for subchapter S corporations?

20 MR. FINNIGAN: You mean other state commissions
21 or state tax entities?

22 Q BY MS. TENNYSON: Other state commissions.

23 A I am not familiar with all 50 state
24 commissions, as to how they treat different regulated
25 and nonregulated items.

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1 Q Are you familiar with any of them, other than
2 Washington?

3 A Not with current information, no.

4 Q Returning to your testimony at page 8, lines 4
5 to 6, you are talking about the question of who's paying
6 the taxes, and --

7 A I am sorry. What line?

8 Q You are referring at line 6 -- or it's sort of
9 in between. You talk about begging the question of
10 treatment of other business entities where tax is not
11 paid directly by the regulated utility.

12 Now, Mr. Kermode isn't the one raising the
13 issue of who pays the tax. The person who pays the tax
14 determines the source of the tax liability, does he?
15 That's something the Company has raised.

16 A I believe he does, in his testimony, when he
17 states that -- and I am not direct quoting right now,
18 because I don't know his testimony verbatim. But he
19 states that subchapter S corporations don't pay tax.
20 Instead, it's paid at the shareholder level. So I think
21 the answer to your question is, I do believe that he
22 makes that distinction.

23 Q I think we have a semantics difference, but
24 it's not worth the time to sort out at this point.

25 Now, the shareholders of Rainier View Water are

0233

1 Mr. Richardson and his wife; is that correct?

2 A I believe that's correct.

3 Q And on page 9 of your testimony, you indicate
4 that a way to demonstrate that the income tax liability
5 truly sits with the Company, if the Company did not --
6 is that if the Company didn't pay its income taxes, the
7 IRS would pursue the utility.

8 Can you tell us what the basis is for that
9 statement?

10 A I believe that Mr. Ault has already answered
11 that question in his rebuttal testimony, and also on the
12 stand. And I think that he's got much better references
13 that I could give you.

14 Q So is your testimony that the basis for that
15 statement is Mr. Ault's testimony?

16 A Mr. Ault's testimony, discussions with
17 Mr. Ault, and discussions with other CPAs.

18 Q That is referring to the alter ego theory that
19 he discussed yesterday?

20 A Correct.

21 Q Now, when a C corporation pays dividends to the
22 shareholders, the corporation doesn't become liable for
23 the shareholders' taxes on those dividends, does it?

24 A No. The corporation has already paid the tax
25 on its income, and the distribution of dividends is a

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1 return on the investment of the shareholder.

2 Q You also state on page 9, if the Shareholder
3 didn't pay their taxes, then the IRS would pursue
4 collection of the taxes from the regulated company.

5 Wouldn't the IRS pursue Mr. Richardson and his
6 assets first, or put a lien on the stock of the Company
7 before seeking payment from the Company?

8 A Potentially. But we're talking about large
9 sums of money, and the IRS, in its nature, has a
10 tendency to go for where the money is.

11 Q Do you have any experience with the IRS and tax
12 collection and tax liens?

13 A I have never worked for them, so no.

14 Q On page 10 of your testimony, you talk about
15 cost of capital. At least that's what my notes say.

16 MR. FINNIGAN: I don't see the question.

17 Q BY MS. TENNYSON: Actually, on mine I think it
18 would be line 15.

19 JUDGE SCHAER: What page, again, please?

20 MS. TENNYSON: Page 10.

21 JUDGE SCHAER: Mine is hole punched, too.

22 Q BY MS. TENNYSON: If the Commission chooses to
23 agree with Mr. Kermodé's theory, then the risk component
24 to the rate of return on equity should be adjusted
25 accordingly. Do you see that?

0235

1 A Uh-huh, yes.

2 Q Isn't it true that Mr. Kermode's recommended
3 rate of return in this case is based on the debt service
4 coverage, and not on a calculated equity return?

5 A I would have to look at his testimony in
6 greater detail to determine that. The statement that I
7 made here was simply to show that there -- if the
8 Commission chooses to adopt Mr. Kermode's
9 recommendation, if you think of it in a sense of
10 percentages, okay, without looking directly into the
11 results of operations of Mr. Kermode and the calculation
12 of the rate of return -- let's assume, for the sake of
13 illustration, that he chose 10 percent return on equity.

14 So essentially, whatever investment
15 Mr. Richardson has in the Company, he would potentially
16 receive 10 percent on that return, or on that
17 investment. However, if he, on his personal income
18 taxes, is liable for 39 percent income tax, essentially
19 he's losing 29 percent in a very simple calculation.

20 And so my statement here was simply to make the
21 point that if no allowance to income taxes is included
22 in rates, Mr. Richardson, in fact has a very negative
23 benefit to investing in Rainier View. And personally,
24 if I was Mr. Richardson, I certainly wouldn't leave my
25 investment in that kind of a situation. I mean, anybody

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1 who invests is seeking a return of some form or another.
2 And if the amount that you are paying in income taxes
3 far exceeds what you would receive as a return on your
4 investment, why would you continue to do that?

5 Q So, then, if Mr. Kermod's recommendation is
6 not based on -- or it is based on the debt service
7 coverage, and not a calculated equity return, then the
8 risk component isn't really a factor, is it?

9 A I believe it still is. Because regardless of
10 how the return was calculated, there's still the bare
11 numbers.

12 If Mr. Richardson is not receiving, from the
13 Company, in the form of return, however calculated, of
14 some form that is at least equal to or greater than to
15 provide him a return on his investment of the cost of
16 income taxes to him on the investment that he's made, my
17 statement still stands. Why would anybody continue to
18 do that?

19 Q Okay. You go on to state at page 10, then, it
20 could be detrimental to the customers of a sub S
21 corporation if any of the shareholders chooses to
22 liquidate their stock.

23 How would it be detrimental to the customers if
24 Mr. Richardson sold his stock in the Company?

25 A How would the Company pay Mr. Richardson for

0237

1 his investment? Mr. Richardson would surely expect to
2 receive cash for his investment.

3 Q Okay. Your answer is assuming, then, that the
4 corporation is buying back the stock. I said if he sold
5 his stock.

6 A Correct.

7 Q I am assuming Mr. Finnigan decides to buy his
8 stock.

9 MR. FINNIGAN: I want, on record, to say I
10 would not do that.

11 THE WITNESS: Which answers your question right
12 there. If Mr. Richardson chose to sell his stock based
13 on the fact he's not making any money, and it is, in
14 fact, costing him money, who would buy it?

15 Q BY MS. TENNYSON: Assuming Mr. Richardson did
16 sell his stock at a price he felt was appropriate, what
17 changes would there be on the books of the Company for
18 the shareholders of the stock?

19 A If who bought it?

20 Q If just a private person bought it?

21 A If there if a private person that bought it,
22 there would be no changes on the books of the Company.

23 Q If there were no changes on the books of the
24 Company, how would it be detrimental to the customers if
25 the stock was sold?

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1 A I guess what I should have said is if
2 Mr. Richardson sold the shares back to the Company.

3 Q On page 12 of your testimony, you start talking
4 about the issues surrounding the ready to serve charge,
5 and you refer to Mr. Kermode defining revenues as
6 guaranteed revenues in his response to a data request.

7 A Correct.

8 Q We have marked as an exhibit that Response to
9 the Data Request. Do you have a copy of that?

10 A Exhibit 47?

11 Q Yes, that's correct.

12 A Yes.

13 Q Now, in fact --

14 JUDGE SCHAER: For identification?

15 MS. TENNYSON: Yes, Exhibit 47 for
16 identification.

17 Q BY MS. TENNYSON: So obviously you are familiar
18 with this document?

19 A Yes.

20 Q You have reviewed it, and you cite to it in
21 your testimony?

22 MS. TENNYSON: I would offer Exhibit 47.

23 MR. FINNIGAN: The only problem I have is that
24 the second page of Exhibit 47 was not provided with the
25 Data Request.

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1 MS. TENNYSON: Yeah. And I realized that last
2 night. I don't have a problem. It just has the same
3 language, so I don't have a problem with detaching it.

4 MR. FINNIGAN: Yeah, just so the record is
5 clear.

6 JUDGE SCHAER: Let's proceed in that manner.
7 We will admit the first page, and then I will tear the
8 other page off.

9 MS. TENNYSON: Yes, I recognized that when I
10 reviewed the exhibits last night.

11 MS. TENNYSON: I would offer 47. Is it
12 admitted?

13 JUDGE SCHAER: I have admitted it with the
14 limitation.

15 (EXHIBIT ADMITTED)

16 MS. TENNYSON: Okay. Thank you.

17 Q BY MS. TENNYSON: Now, in fact, what you are
18 referring to here is not a statement of Mr. Kermode, is
19 it? It is, in fact, the title of a NARUC Uniform System
20 of Accounts number?

21 A Well, we use guarantee and guaranteed revenues
22 quite frequently throughout both of our testimonies. So
23 if you could direct where you are asking me, in
24 particular.

25 Q Your testimony at page 12, line 15, states that

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1 Mr. Kermode defines these revenues as guaranteed
2 revenues?

3 A Correct. In his testimony, he does define
4 those revenues as guaranteed revenues.

5 Q That's not what your testimony even says, Ms.
6 Ingram. You are saying that in this response to the
7 data request, is where that is stated.

8 A I am sorry. Correct.

9 Q So your reference and characterization of
10 Mr. Kermode as stating this -- my point is, isn't it
11 simply the statement, the title of this NARUC Account
12 Class that uses the term guaranteed revenues?

13 MR. FINNIGAN: I am going to object. First of
14 all, the exhibit speaks for itself. But in addition,
15 that mischaracterizes the question that was asked, and
16 this is a response to a question that was asked.

17 So it has to be placed in the context of what
18 was being provided by Mr. Kermode in response to a
19 question.

20 MS. TENNYSON: My point that I am seeking with
21 this is that I believe Ms. Ingram has mischaracterized
22 what Mr. Kermode has said. She is attributing this
23 particular statement to Mr. Kermode when it is simply a
24 quote from a separate source. It is not his words.

25 JUDGE SCHAER: Well, can you ask her -- this

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1 part of Exhibit 47 is admitted. Ask her if this is the
2 data request upon which she bases her testimony
3 at this point, and then ask her what, in this data
4 response, leads her to make this statement, and perhaps
5 we can get there in that way.

6 Go ahead, Ms. Tennyson.

7 MS. TENNYSON: Okay. Thank you.

8 Q BY MS. TENNYSON: In your testimony at page 12,
9 starting at lines 15 -- 14, 15, the sentence that
10 starts, "First of all, Mr. Kermode," is this Exhibit 47
11 what you are referring to as the data response?

12 A Yes.

13 Q And the reference to guarantee that you refer
14 to in your testimony, again, that is simply from this
15 document, and not from another source in Mr. Kermode's
16 testimony?

17 A Correct.

18 Q And you refer, again, to the data response on
19 page 13, the first two lines. And you are attributing
20 to Mr. Kermode the statement that the ready to serve
21 charges paid guarantee a connection to the water system
22 in the Staff response to data request?

23 A Correct.

24 Q And, again, you are referring here to Exhibit
25 47?

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1 A Correct.

2 Q Now, under -- when a lot is sold to an end
3 user, and they start receiving water, that person is
4 clearly a customer of the water company, correct?

5 A Correct.

6 Q At that point, they would begin paying rates
7 for water service?

8 A Correct.

9 Q So under the developer contracts under which
10 Rainier View charges the ready to serve charge, at that
11 point, the Company would start receiving revenue from
12 the customer, rather than revenue from the ready to
13 serve charge, correct?

14 A I don't follow your question completely.
15 Could you restate it?

16 Q Certainly. It was rather confusing. I am
17 sorry.

18 At the time that a customer hooks up and starts
19 receiving water, then that essentially replaces revenue
20 that the Company would receive from the ready to serve
21 charge?

22 A At the time that a customer, a person who
23 purchased the lot, pays the service connection fee,
24 receives the water availability letter, et cetera, at
25 the time that all of that occurs, they begin paying

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1 rates. If there is a contract in place that is still
2 active on that particular lot prior to the sale, at the
3 time of the sale the developer is no longer responsible
4 for the ready to serve charge.

5 Q And are you familiar with Rainier View's rate
6 structure, the rates for water service to customers?

7 A A general familiarity, yes.

8 Q Could you tell us the amount that a normal
9 customer would pay for water services? At least as much
10 as the \$15 per month, possibly higher?

11 A I can't answer that without looking at their
12 tariff.

13 Q Going on to page 14 of your testimony at line
14 24, you used the term capital asset ratio. Can you tell
15 us what the capital asset ratio is? Describe that for
16 us.

17 A A capital asset ratio is the ratio of
18 contributed plant to total plant.

19 Q And for a regulated water company, what kind of
20 ratio is preferred?

21 A Well, while I don't have access to what the
22 Commission uses currently as their guideline, at the
23 time I was employed by the Commission, Mr. Jim Ward of
24 the Commission Staff was seeking a 30 percent capital
25 asset ratio for companies when determining a financial

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1 viability and feasibility of a water system plant.

2 Q And if I understand it correctly, it would be,
3 then -- the Company would be seeking to have a larger
4 ratio; that is, one with less CIAC funded plant as
5 opposed to investment?

6 A Actually, I believe that the 30 percent was
7 indicating -- I would have to look into that. I can't
8 answer that.

9 Q I am still on page 14, line 21. You state that
10 the purpose of the charge as a financing mechanism was
11 initially instituted to increase the rate base.

12 Could you explain briefly how rate base is
13 increased by the use of this charge?

14 A The use of this charge is part of the contract.
15 And the contracts were developed as they were so that
16 the Company would actually be buying the assets of the
17 developer, as opposed to the developer simply giving the
18 Company the assets.

19 If the developer gives the Company the assets,
20 they have received contributions, which erodes rate
21 base. If they are purchasing the assets, then they are
22 allowed to place that into the rate base, and therefore,
23 are able to increase their rate base.

24 Q Now, I would like to just pose a hypothetical
25 here, and see if we can follow along here.

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1 Let's assume that a developer installs a
2 company utility plant, and the Company and the developer
3 value that at \$200,000. The Company issues a note
4 payable for \$200,000 to the developer.

5 So then, in the Company -- under Rainier View's
6 contracts, the Company has the developer pay an amount
7 of money on -- the \$15 per month, in order to have the
8 cash to pay the developer back the utility plant that
9 they are buying; is that correct?

10 A Well, with a dollar figure like \$200,000 I
11 doubt that the \$15 would cover the total payments. But
12 it certainly is a revenue source that the Company would
13 have available to make the debt service on that.

14 Q But at the beginning of this contract, we have
15 got rate bases increased by \$200,000, but that's solely
16 by debt; is that correct?

17 A That's correct.

18 So, now, I am not talking about reality and the
19 figures. But let's say the developer pays \$50,000 in
20 the ready to serve charges to Rainier View for the first
21 year. What would the capital structure look like at the
22 end of the first year? Let's disregard depreciation or
23 anything like that. We have had the \$200,000 debt, and
24 the developer has paid Rainier View \$50,000 that Rainier
25 View pays to the developer. What is our capital

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1 structure?

2 A The capital structure would be, assuming
3 that --

4 MR. FINNIGAN: I am sorry. I am not sure this
5 hypothetical is going to be helpful, because it's
6 missing a couple of key elements. It's missing the
7 payment schedule on the note, and the interest rate on
8 the note.

9 MS. TENNYSON: I'm not talking about reality.
10 I am trying to get an idea of the debt and the equity,
11 where it goes.

12 MR. FINNIGAN: But even to do that, as you go,
13 I understand -- I think I understand where you are
14 trying to go, and I don't have any objection to getting
15 that, but that is part of the record.

16 But I am saying, as stated, I don't think you
17 have asked a hypothetical question that can be answered
18 as positive. As you can now ask what the rate base
19 would be at the end of the first year, and to know that
20 you would need to know the payments under the note as
21 opposed to the payments by the developer.

22 MS. TENNYSON: That was part of my question. I
23 said, we have \$200,000 in debt, and the developer pays
24 Rainier View \$50,000; Rainier View pays \$50,000 to the
25 developer. I did say that.

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1 JUDGE SCHAER: There was an objection to the
2 form of the question as being incomplete, and I am going
3 to let you restate the question. And if there is
4 something that the witness finds makes her unable to
5 answer because it's essential to being able to give an
6 answer, I will let her tell you that.

7 But I think that you are looking for pretty
8 gross figures: Does it go up? Does it go down? Or
9 does it stay the same? And I think we can get to
10 those. We won't get to a precise number, and if you
11 were to attempt to do that, I would have more concern.
12 But let's go ahead.

13 Q BY MS. TENNYSON: Okay. So we have rate base.
14 At this point, we have \$200,000 of rate base that is
15 debt. And then the developer pays \$50,000 to the
16 Company in ready to serve charges, and then Rainier View
17 pays the developer \$50,000 on that note that they have.
18 What is the capital structure at this point?

19 A Well, in your question, the only figures that
20 play into the capital structure are the \$200,000 in
21 beginning debt rate base, and the \$50,000 paid on that
22 to the developer. The ready to serve charges don't
23 factor into the calculation of capital structure.

24 As such, assuming that the \$50,000 paid to the
25 developer was solely for principal, and not calculating

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1 any interest into it, then at the end of the year, at an
2 end of the year rate base figure, not averaging or
3 anything, you would have \$150,000 of debt in your rate
4 base, and \$50,000 in equity.

5 Q Okay. Let's take it forward three years.
6 Again, we will disregard depreciation and interest as
7 you appropriately pointed out. At the end of that
8 period of time, then, the capital structure would be,
9 the Company would have \$200,000 of equity, correct?

10 A If you are making the assumption that they
11 continue to pay \$50,000 per year in principal, then,
12 yes, they would have \$200,000 in equity after four
13 years.

14 Q So at this point the Company would have an
15 additional \$200,000 of equity, but there has not been
16 any investment by the shareholder; is that correct?

17 A That's correct.

18 Q All right, expenses --

19 A Can I expand on that? There hasn't been an
20 investment from the shareholders in the sense that they
21 haven't paid any money into the Company in addition to
22 the original investment. However, their original
23 investment is what created the Company. And as such,
24 they have the ability to -- the Company has the option
25 to distribute any residual income to any shareholders or

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1 investors, or so forth.

2 By the Company investing that into plant, as
3 opposed to returning it to the shareholders, in essence
4 the shareholders have invested in the sense they have
5 given up the opportunity to receive that money.

6 Q Are expenses relating to operation -- well,
7 assuming -- we're back to the hypothetical. And we have
8 this utility plant, that is being -- the money is being
9 exchanged or is being purchased.

10 Are the expenses relating to the operation of
11 that utility plant included in the company's cost of
12 service?

13 A I don't know. It depends upon how the Company
14 structures its rates.

15 Q Would it be included in the company's results
16 of operations?

17 A Again, I don't know that. In your
18 hypothetical, I don't know all of the circumstances
19 surrounding your hypothetical.

20 Q Now, you testify about the company's contracts,
21 and the calculations -- or how the ready to serve
22 charges works. Now, you weren't part of the Company or
23 associated with the Company at the time they developed
24 this financing mechanism, were you?

25 A I was employed by the Commission at that time.

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1 Q So your knowledge of the purpose of the
2 contracts, and how they were set up was developed from
3 your conversations with the Company since then?

4 A No. Like I said, I was employed by the
5 Commission at the time that these were developed. And
6 as such, I worked for the water section Staff, and the
7 issue was hashed around over and over and over to
8 develop this particular program.

9 Q Now, the ready to serve charge in the contracts
10 that you were present, I think, for part of the
11 testimony yesterday -- and if we need to refer to a page
12 in the contract, we can do that.

13 But would you agree the contract says the ready
14 to serve charge continues to the time the residential
15 subscriber purchases the lot, or becomes a customer?

16 A Or until the contract expires, yes.

17 Q Now, do you know how it would work if a person
18 paid the connection charge, but didn't actually start
19 receiving water until several months later? Would the
20 developer's obligation stop at the time the person
21 purchased the lot?

22 A I believe so.

23 Q Now, if we have contracts that were entered
24 into in 1999 that include a ready to serve charge, if we
25 assume there's a five-year term, the Company would still

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1 be receiving ready to serve charges, or could be still
2 receiving ready to serve charges for developers under
3 those contracts; is that true?

4 A At the present time, if the lot has not been
5 sold and there isn't an active customer, yes.

6 Q So when you testify that -- on page 17, that
7 the Company is no longer assessing these charges in the
8 contracts, what you mean is that current contracts that
9 are being entered into don't include this language?

10 A Yes.

11 Q Do you know at what date the Company stopped
12 including the ready to serve charge in its contracts?

13 A I don't know the exact date, no.

14 Q Do you know the year?

15 A I believe it was last year.

16 Q The year 2000 -- or 2001, I am sorry?

17 A I believe that's correct.

18 Q I would like you to refer to Exhibit 44 at this
19 time.

20 A (Complies.)

21 Q Now, are you familiar with this document
22 at all?

23 A (Reading document.) I believe I received it
24 yesterday. So in the sense that I received it
25 yesterday, yes, I am familiar with it.

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1 Q And now the attachments to it, these are some
2 copies of portions of the Company's depreciation
3 schedules; is that correct?

4 A That appears to be what this is, yeah.

5 Q And now the question that is asked relates to
6 the acquisition of Indian Springs, and it refers to the
7 attachment labeled Attachment A. Have you had an
8 opportunity to review that?

9 A No.

10 Q So you don't know whether that does relate to
11 the Indian Springs --

12 A Well, I can see that it says that included
13 assets related to the Indian Springs acquisition.

14 Q Now, do you know what year the Indian Springs
15 system was transferred into Rainier View Water?

16 A Not without reviewing my passport papers.

17 Q Could you refer to what has been marked as
18 Exhibit 48.

19 A (Complies.)

20 Q And can you identify this for us?

21 A The year that Rainier View acquired Indian
22 Springs?

23 Q No, identify the exhibit.

24 A Yes.

25 MR. FINNIGAN: Before we go too far, all of

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1 this has been sort of preliminary. I have been
2 wondering, but I would like to inquire where this line
3 of questioning is going, because it appears to me to be
4 outside the scope of Ms. Ingram's testimony. She
5 testified on two subjects, and I think we're going into
6 an area where she didn't provide direct testimony.

7 MS. TENNYSON: And she was, in fact, the
8 analyst who dealt with Indian Springs, and putting it
9 into rate base, and the depreciation of it.

10 It is Staff's belief that the issues -- some of
11 the adjustments on depreciation that the Company made on
12 its catch-up adjustments related to this particular
13 acquisition. And since she was the person with the most
14 direct knowledge of how the depreciation expense was
15 included in inputting this item into rate base, I think
16 it's important to establish that point.

17 MR. FINNIGAN: Well, we have a couple of
18 issues. That's clearly beyond the scope of Ms. Ingram's
19 direct case. And I suppose Staff is attempting to make
20 Ms. Ingram their witness on a particular issue.

21 The second is, I have tried to be very careful
22 in -- at least in our preparation of testimony to
23 respect both Ms. Ingram and Ms. Parker's roles with the
24 staff, and not ask them to testify exactly what they did
25 or didn't do as a staff member on a particular -- in a

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1 particular case.

2 And I am not 100 percent bothered, because the
3 ethics statutes are always changing, but at one time
4 asking someone to do that would place them in the
5 position of violating state statute. And so I have a
6 concern there, and I stayed away from those areas
7 specifically for that reason.

8 JUDGE SCHAER: Mr. Finnigan, do you have a
9 witness who can talk about depreciation, and talk about
10 how Indian Springs was treated in terms of depreciation
11 among the four witnesses you have presented?

12 MR. FINNIGAN: Depending on the issue that they
13 want to ask, I suppose Mr. Fisher would have been the
14 witness to discuss it. But, again, it depends on the
15 question, and what they are going into.

16 JUDGE SCHAER: Well, you wanted to stop this
17 before we got to the questions. So I think we're
18 looking at whether or not -- what path we're on. And
19 what I have heard is we're on a path of checking whether
20 or not depreciation catch-up, which is in the Company's
21 case, was done appropriately. And I think there should
22 be someone that Staff can ask those questions of.

23 MR. FINNIGAN: We had Mr. Fisher, who has the
24 results of operations page where it appeared, and
25 Mr. Ault.

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1 MS. TENNYSON: Mr. Ault testified he couldn't
2 tell us what was included in their changes to the
3 depreciation schedules.

4 JUDGE SCHAER: Well, Ms. Tennyson, I think that
5 Mr. Fisher is here. If we need to recall him we will,
6 because I think that Staff should be able to have a
7 witness to talk about -- answer questions about
8 depreciation in this rate case.

9 I am concerned with Exhibit 48. Mr. Fisher
10 will not be able to sponsor it, because he's not one of
11 the authors. So I --

12 MR. FINNIGAN: I don't think we're asking about
13 48. Oh, I am sorry, 48.

14 MS. TENNYSON: Well, I could propose that we
15 admit Exhibit 48, and I don't ask any questions about
16 it.

17 JUDGE SCHAER: We're going to take our break
18 about 10:30, and I would like the two of you to talk
19 over the break, because I know there's important
20 questions about depreciation, and whether we got it
21 right. And I would like to have those explored, so we
22 need to figure out how to go forward on that.

23 MR. FINNIGAN: That would be fine. If I
24 understand the direction that they may be going, and
25 maybe we can solve that.

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1 JUDGE SCHAER: As I say, I would like you and
2 Ms. Tennyson to talk this over at 10:30.

3 MS. TENNYSON: I have no further questions.

4 JUDGE SCHAER: Well, maybe we will have a nice
5 early break, because I only have a couple.

6

7 EXAMINATION

8 BY JUDGE SCHAER:

9 Q Good morning, Ms. Ingram.

10 A Good morning.

11 Q I would like you to turn to page 8 of your
12 testimony.

13 A (Complies.) And I am asking you this question
14 as someone at a prestandard level of understanding of
15 how tax reporting is done. So I am looking for the
16 basics.

17 You discuss between lines 7 and 10 that the
18 sole proprietorships and partnerships, as I read it, pay
19 tax in a similar way to an S corporation?

20 A Correct.

21 Q How does a sole proprietorship pay tax?

22 A A sole proprietorship pays tax off the
23 individual's income tax return. And I believe that the
24 revenues and the expenses of the Company are placed on
25 Schedule C, which is -- like Schedule A is the itemized

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1 deductions on your tax return, Schedule C is business
2 income.

3 Q So that's a normal 1040 and Schedule C?

4 A Correct.

5 Q And that is, then, taxed one time when the sole
6 proprietor reports her income?

7 A Correct.

8 Q How does a partnership pay tax?

9 A Similar. If I am not mistaken it's exactly the
10 same way, but perhaps you could ask that question of
11 Ms. Parker who is a CPA, also.

12 Q So if we have a partnership of two people who
13 are unrelated otherwise, what do you do? Put half the
14 income on one, and half on the other?

15 A I believe in cases like that, the income is
16 distributed based upon percentage of ownership. So if
17 one person of the partnership owns 60 percent, they
18 would receive 60 percent of the business income for
19 reporting on the tax return. And the other partner at
20 40 percent would receive 40 percent of the income to
21 report.

22 Q And the tax would be based on the tax schedules
23 for an individual, or however the person reports --
24 whether they are an individual, or married, or something
25 else. But it would be the tax table that would

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1 accompany the 1040?

2 A Correct.

3 Q Or the calculations you would do, or it would
4 be the calculation you have to do if you are earning
5 more than the 1040 has tables for? It would be the 1040
6 tax level?

7 A Correct.

8 Q Thank you.

9 MR. FINNIGAN: Ms. Tennyson, do you have any
10 follow-up?

11 MS. TENNYSON: No, I don't.

12 JUDGE SCHAEER: Why don't you go ahead on
13 redirect for everything up to this point. And after we
14 go further on this depreciation question, you can have
15 more redirect on that, Mr. Finnigan.

16

17 REDIRECT EXAMINATION

18 BY MR. FINNIGAN:

19 Q Ms. Tennyson asked you a question concerning a
20 person who pays the connection charge, and whether the
21 ready to serve charge continued. Do you remember those
22 questions?

23 A Yes.

24 Q Is it your understanding that a person who pays
25 the connection charge becomes a customer?

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1 A Yes.

2 Q There were some questions to you concerning
3 your testimony on page 14, lines 24 through 27,
4 concerning capital asset ratios?

5 A Correct.

6 Q Is it your understanding of the capital asset
7 ratios that 30 percent of the plant should be rate base?
8 Is that where the 30 percent capital asset ratio comes
9 from?

10 A I would have to go back and look at my
11 paperwork.

12 Q Would you look at Exhibit 47, which is Data
13 Request No. 2.

14 A (Complies.)

15 Q And as I understand it, you reviewed this data
16 request and it formed a basis for a portion of your
17 testimony?

18 A Correct.

19 Q Could you tell us from this document what led
20 you to conclude that -- to make the conclusion that you
21 drew in your testimony?

22 A Could you restate that question?

23 MS. TENNYSON: I object to the form of the
24 question. I don't believe she made a conclusion. She
25 just attributed a statement to Mr. Kermode in her

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1 testimony.

2 JUDGE SCHAER: I think Mr. Finnigan already
3 stated he would restate the question, so let's let him
4 do that, please.

5 MR. FINNIGAN: It would be helpful if someone
6 could give me the page citation, because I missed that
7 in my notes.

8 THE WITNESS: Page 12.

9 MR. FINNIGAN: Thank you.

10 Q BY MR. FINNIGAN: At page 12, lines --
11 approximately lines 13 through 16, could you tell us
12 what about Exhibit 47 led you to make the statement
13 contained there?

14 A Mr. Kermode, in answering this data request
15 with the citation of the NARUC Uniform System of
16 Accounts for class A water utilities, I believe is
17 answering the question posed to him of whether ready to
18 serve charges are utility revenue or not. And he uses
19 the definition of guaranteed revenue to indicate that
20 they are utility operating income.

21 What I am saying in my testimony is that I
22 don't believe that ready to serve charges, in the sense
23 that Rainier View charges them in the contracts, qualify
24 as guaranteed revenues, based upon the fact that this
25 definition indicates that this type of revenue is

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1 usually received to reserve or guarantee the
2 availability of plant capacity when needed.

3 That, to me, indicates that guaranteed revenues
4 are received for the purpose of ensuring a service
5 connection, which is not a condition of the ready to
6 serve charge. The ready to serve charge does not
7 guarantee the developer a service connection for that
8 particular lot. That is guaranteed at the time a
9 service connection charge is paid, and a water
10 availability letter is issued, and an application for
11 service is received.

12 Q Turning now to page 10 of your testimony --

13 A (Complies.)

14 Q -- in the middle of the page you were asked
15 questions concerning risk component. Do you remember
16 those questions?

17 A Correct.

18 Q One of the questions was whether or not there
19 would be a detriment to the Company if Mr. Richardson
20 sold his stock to another person. Do you remember those
21 questions?

22 A Yes.

23 Q Would there be any detriment to the Company
24 beyond just the book entries that you were asked about
25 upon a possible sale by Mr. Richardson's interest in

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1 Rainier View Water Company?

2 A To another private individual?

3 Q To a private individual.

4 A Well, first of all, if the sale occurred to
5 another private individual, there would be no effect on
6 Rainier View's books as there would still be shares
7 outstanding equal to the amount outstanding prior to the
8 sale.

9 However, there's a myriad of potential
10 detriment that could happen to a company, depending on
11 the new investor, and what their motives are.

12 Q It's possible the new investor may not have the
13 same qualifications as Mr. Richardson?

14 A Correct.

15 MS. TENNYSON: I would object to Mr. Finnigan
16 leading the witness.

17 Q BY MR. FINNIGAN: Could you give us some
18 examples of the types of detriment you just indicated in
19 response to the question?

20 A Well, I think that qualified owners of water
21 companies are very few and far between. There are a
22 number of things that a person needs to recognize when
23 purchasing a water company, especially a regulated
24 company.

25 In Mr. Richardson's case, he has a long history

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1 of owning Rainier View. He's familiar with the
2 operations. He's familiar with the personnel. He's
3 familiar with the regulatory environment. He's in -- he
4 has access to related companies that can provide him
5 service on an emergency basis. He has a good reputation
6 in the industry, has a good relationship with his
7 managers. And as such, is very hands on. I don't think
8 that there's any guarantee that another investor could
9 be the same. While it's not impossible, it would be
10 very rare.

11 Q I want to go next to page 7 of your testimony.

12 A (Complies.)

13 Q And in response to questions related to your
14 testimony, on page 7 you use the phrase "double
15 taxation." Do you remember that conversation?

16 A Yes.

17 Q What do you mean by "double taxation"?

18 A What I mean by that is a particular dollar of
19 revenue runs the risk of being taxed twice. And in the
20 example I gave when answering one of Ms. Tennyson's
21 questions, was in a C corporation where the corporation
22 receives revenue from whomever it sells commodities or
23 whatever to, that income is taxed at the corporate
24 level.

25 Then from there, the corporation distributes

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1 dividends to its shareholders, assuming it elects to
2 distribute dividends. Those dividends are cashed from
3 the Company, which has to come from some source. And
4 for the purposes of this illustration, it came in from
5 taxable income. And then the shareholder pays tax on
6 the dividends on their personal returns.

7 So in essence, that dollar received as a
8 dividend has been taxed as an income to the corporation.

9 Q Do I understand that to mean that that dollar
10 is potentially subject to being taxed more than once?

11 A Correct.

12 Q Do you remember being asked questions about
13 future tax benefits to owners?

14 A Yes.

15 Q What do you have in mind when you hear the term
16 future tax benefits to owners?

17 A Future tax benefits to owners, I don't recall
18 the exact question that was asked when I was asked about
19 future tax benefits to owners.

20 But what that statement implies to me is that
21 something that happened in the past creates a benefit
22 for taxation purposes in the future.

23 Q In a situation, again, there both being future
24 tax detriments and future tax benefits?

25 A Yes.

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1 Q Are you aware how the Commission, this
2 Commission, treated tax associated with contribution in
3 aid of construction from service connections prior to
4 the Tax Reform Act of 1986?

5 A No.

6 Q Ms. Tennyson asked you about a concept of a
7 flow-through tax. Do you remember that question?

8 A Yes.

9 Q In your mind, what is a flow-through tax?

10 A A flow-through tax, synonymous with a
11 pass-through tax, would be where a transaction occurs
12 that creates a tax liability. And the person who is
13 receiving the benefit of that transaction would be the
14 person who would actually pay the tax to the IRS, remit
15 the tax to the IRS. However, they collected from
16 whomever they sold something to to cover that liability.

17 So in the case of Ms. Tennyson's question, she
18 was asking about service connection fees, I believe. So
19 someone comes to -- let's use Rainier View as an
20 example -- wants to purchase a service connection fee.
21 Rainier View charges them the service connection fee,
22 plus the associated tax. So in the end, as Mr. Fisher
23 testified yesterday, they will end up receiving -- the
24 Company will end up receiving \$350 for their service
25 connection fee, even though the tax liability on that is

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1 also collected -- that's not very clear.

2 Q Well, let me ask you another question. Is a
3 sales tax an example of a flow-through tax?

4 A Yes.

5 Q And continuing and concluding -- I am working
6 here by going backwards.

7 You were asked certain questions concerning
8 your experience with Federal income tax. Do you
9 remember those questions?

10 A Yes.

11 Q You were asked about your employment. Is it
12 also true that you were employed by a regulated water
13 utility?

14 A Yes.

15 Q Did you have any experience with income tax in
16 that position?

17 A I didn't personally prepare the income taxes,
18 but I provided the backup documentation for many of the
19 portions of the calculations for income tax.

20 Q And you previously testified that you were
21 employed here at the Commission; is that correct?

22 A Correct.

23 Q And did that position require you to review
24 income tax adjustments for regulated water companies?

25 A Yes.

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1 MR. FINNIGAN: That concludes my redirect.

2 JUDGE SCHAER: Thank you. I am going to
3 suggest we take our morning recess at this time. Please
4 be back at 10:35 by the clock on the wall. Thank you.

5 We're off the record.

6 (Brief recess.)

7 JUDGE SCHAER: Let's be back on the record
8 after our morning recess.

9 I believe, Ms. Tennyson, and Mr. Finnigan, you
10 were going to report back on some concerns about
11 exhibits. And can you let me know where we are
12 at this point, please?

13 MS. TENNYSON: We have discussed the proposed
14 questioning and the topic of Exhibit 48. And we have
15 agreed to admit the exhibit by stipulation without any
16 testimony related to it.

17 JUDGE SCHAER: All right. The other exhibits
18 that I have listed as associated with this witness that
19 I don't know at this time where we are, are Exhibits 44
20 and 49.

21 (EXHIBIT ADMITTED)

22 MS. TENNYSON: And I have not offered those,
23 and I do not intend to offer those at this time.

24 JUDGE SCHAER: Okay. Thank you. And I believe
25 I reminded you before the break ended that there are

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1 still two outstanding exhibits from yesterday. We will
2 keep track of those as we go through the day, so we know
3 what their status is.

4 Mr. Finnigan, would you like to call your next
5 witness.

6 MR. FINNIGAN: I would like to call Ms. Parker,
7 please.

8 JUDGE SCHAER: Please raise your right hand.

9

10 JULIA PARKER,
11 produced as a witness in behalf of the Respondent, having
12 been first duly sworn, was examined and testified as follows:

13

14 JUDGE SCHAER: Go ahead, Mr. Finnigan.

15 MR. FINNIGAN: Your Honor, I think we need to
16 identify Ms. Parker's exhibits.

17 JUDGE SCHAER: I am going to identify
18 Ms. Parker's prefiled rebuttal testimony as T-50, and
19 her Exhibit JMP-2 as 51. And her Exhibit JMP-3 as 52.

20 And Ms. Tennyson, did you have any cross
21 exhibits for Ms. Parker?

22 MS. TENNYSON: No. We will be using Exhibit 27
23 and asking her to identify that.

24 JUDGE SCHAER: Okay.

25 MR. FINNIGAN: Do you have an additional copy

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1 of that?

2 MS. TENNYSON: Yes, I do. I will also allow
3 her to have this available, if she needs it.

4 JUDGE SCHAER: Go ahead, Mr. Finnigan.

5 MR. FINNIGAN: Thank you.

6

7 DIRECT EXAMINATION

8 BY MR. FINNIGAN:

9 Q Ms. Parker, do you have what have been marked
10 as T-50, 51, and 52?

11 A Yes, I do.

12 Q And we have previously submitted an errata
13 concerning Exhibit T-50; is that correct?

14 A Yes.

15 Q With the changes noted on the errata -- I am
16 sorry. I got out of order.

17 Is the material in T-50 prepared by you, or
18 under your supervision and direction?

19 A Yes, it is.

20 Q And would that be the same for Exhibits 51 and
21 52?

22 A Yes.

23 Q And with the corrections contained on the
24 errata, is the material contained in Exhibits T-50, 51,
25 and 52 true and correct to the best of your information

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1 and belief?

2 A Yes.

3 Q And if I were to ask you the questions
4 contained in Exhibit T-50 today, would your answers be
5 the same as listed there?

6 A Yes.

7 MR. FINNIGAN: I would offer T-50, 51, and 52.

8 JUDGE SCHAER: Any objection?

9 MS. TENNYSON: No.

10 JUDGE SCHAER: The documents are admitted.

11 (EXHIBIT ADMITTED)

12 MR. FINNIGAN: Thank you. Ms. Parker is
13 available for cross examination.

14 MS. TENNYSON: Thank you.

15

16 CROSS EXAMINATION

17

18 BY MS. TENNYSON:

19 Q Good morning, Ms. Parker.

20 A Good morning.

21 Q I am going to refer to your testimony T-50,
22 starting at page 4. And you refer to considerations, or
23 things one would consider in evaluating the salary of an
24 owner of a company. Do you see that?

25 A Yes, I do.

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1 Q Would you also consider the work performed by
2 the person as part of that evaluation?

3 A The duties performed by that --

4 Q -- person.

5 A Yes, that would be a consideration as well.

6 Q Prior to your testimony in this case, did you
7 ever -- have you ever worked for Rainier View Water?
8 Have you done accounting work for them?

9 A I have never been employed by Rainier View
10 Water Company.

11 Q Has your firm done work for the Company?

12 A No, not prior to this case.

13 Q So then when you state that you believe that
14 the salary that Mr. Richardson is requesting is
15 reasonable for what he does, what are you basing your
16 knowledge of what he does on?

17 A My discussions with the Company as to the
18 duties performed by Mr. Richardson, as well as the
19 testimony presented by Mr. Fisher, and by Mr. Ault.

20 Q Going on to page 6, line 16 of your testimony,
21 you refer to companies who have properly recorded their
22 officers' salaries. What do you mean by properly
23 recorded?

24 A When I reviewed the rate case workpapers for
25 various water companies, there were officers' salaries

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1 that were recorded as employee salaries rather than
2 officers' salaries. I have seen it in contract
3 management, instead of officers' salaries. Those are
4 the main places where you might find it.

5 It is very common for the salary of the
6 officers to be not appropriately presented in their
7 financial statements.

8 Q I would like to refer to your Exhibit JMP-2,
9 which is Exhibit 52.

10 JUDGE SCHAER: No, JMP-2 is 51.

11 MS. TENNYSON: I read 51, and my mouth said 52.

12 Q BY MS. TENNYSON: Can you tell us for each
13 company listed on this exhibit what officers that salary
14 amount represents?

15 A I am sorry. On Exhibit 51?

16 Q Yes.

17 A There's no compensation represented on Exhibit
18 51. The compensation is shown on Exhibit 52. It
19 appears as though we left a header on 51 that should not
20 have been there.

21 51 represents the Federal tax and what was
22 booked as proforma, as opposed to what was booked in the
23 Company's financial statements. As well as it presents
24 the number of customers, and type of entity that the
25 Company is operating as.

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1 Q I believe that I am referring to what has been
2 marked as your Exhibit JMP-2.

3 MR. FINNIGAN: I think the exhibits --

4 THE WITNESS: Do I have them marked
5 incorrectly?

6 MR. FINNIGAN: Yes. I think that would help.

7 THE WITNESS: I am sorry. When I set them up I
8 had them marked the other way. I think they were
9 changed since that time.

10 Q BY MS. TENNYSON: So Exhibit 51 does have a
11 column for officers' salaries, correct?

12 A Yes, it does.

13 Q And can you tell us what officers that salary
14 represents?

15 A These were comprised from the results of
16 operations statements, or the -- if I couldn't find it
17 on the results of operations statement, I went to the
18 annual report provided by the Company to the Commission.

19 And so that's simply what is presented in
20 account 602, Officer Salary. Unless I found, through
21 the workpapers, that the owner or officers' salary was
22 booked as contract management, for example, or was
23 incorrectly shown as an employee salary, then it was
24 moved to officers so we could have a complete comparison
25 of those salaries.

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1 Q But from this exhibit, and from what you have
2 said, I gather you can't tell us how many persons may be
3 included in that category, whether the officers are full
4 or part time; is that correct?

5 A That's correct. You can't tell from the
6 exhibit.

7 Q And we can't tell whether the officer might be
8 the only paid employee of the Company, or one of
9 several; is that correct?

10 A That's correct.

11 Q Now, of the companies and the cases that you
12 list on this exhibit, isn't it true that none of these
13 cases went through an adjudication hearing?

14 A I can't answer that for sure. To the best of
15 my knowledge, I did not see a final order on any of
16 these cases, so I don't believe that they were. But I
17 don't have complete knowledge of each and every one of
18 these cases.

19 Q At this point, I would like you to refer to
20 what has been marked as Exhibit 27.

21 A (Complies.)

22 Q And I have also provided to you there on the
23 table, the workpapers from the case that these documents
24 were taken from, which I will represent to you was the
25 filing of Rainier View Water Company under Docket No.

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1 UW-930190, and several other numbers.

2 Looking at page 2 through 4 of this document,
3 can you tell me whether these are workpapers that you
4 prepared?

5 A (Reading document.) To tell you the truth, I
6 know that I prepared the second page of this document.
7 It has my handwriting on it. The first page, most
8 likely would have been prepared by me, because I was on
9 staff at that time, and would have been assigned to this
10 rate case. I don't have any memory of it, but --

11 Q I believe -- you weren't here yesterday.
12 Mr. Fisher identified this as a document provided by --

13 A The third page is not my handwriting. It looks
14 as though it came from a later case, to tell you the
15 truth, which referenced this one. And the handwriting
16 on the fourth page also looks as though it was performed
17 by another auditor, and not myself.

18 Q What leads you to believe that the third page
19 was from a later case?

20 A Well, I had thought I recognized the
21 handwriting, but I could be wrong, based on the
22 information provided.

23 JUDGE SCHAER: Ms. Tennyson, there's a notation
24 on lines 3 and 4 referring to something as "last rate
25 case," and then a number. Perhaps the witness will know

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1 if there were --

2 MS. TENNYSON: That is a good point.

3 Q BY MS. TENNYSON: Ms. Parker, referring to line
4 4 of the document on page -- the third page of the
5 document, it refers to a docket number from what appears
6 to be a 1992 case.

7 Do you know if there were intervening rate
8 cases in between 1992 and 1993?

9 A I don't believe there would be. Looking at
10 this information, my guess today, from looking at this,
11 my impression is this must have been a company-provided
12 workpaper, not provided by myself. Probably presented
13 to justify their proposed proforma adjustment.

14 MS. TENNYSON: Mr. Finnigan, when we had
15 Mr. Richardson on the stand --

16 MR. FINNIGAN: Mr. Fisher.

17 MS. TENNYSON: Mr. Fisher.

18 MR. FINNIGAN: And this is --

19 MS. TENNYSON: I don't recall that we
20 specifically asked him that question.

21 MR. FINNIGAN: Well, he indicated that he
22 agreed that he prepared the first page, but he did not
23 prepare the subsequent pages.

24 And, again, this is one of those where I had
25 asked for the workpapers related to it, and these were

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1 not materials that were provided to me. So I don't have
2 any objection to the second page coming in, based on
3 Ms. Parker's identification, but --

4 MS. TENNYSON: No, I had anticipated that this
5 was her handwriting. So we will -- I would move the
6 admission of the exhibit, the first two pages and remove
7 the last two, since we don't know whose they are.

8 JUDGE SCHAER: I note the last page, this
9 appears to be photocopies out of a text that is in the
10 library -- if it's still there. Maybe something could
11 be referred to, or maybe not. I don't know. But
12 certainly the third page doesn't appear to be identified
13 with anyone.

14 MR. FINNIGAN: And I don't have any objection
15 to the first two pages.

16 JUDGE SCHAER: So I will admit as Exhibit 27 a
17 two-page document; first page stating -- providing
18 employee name and payroll information, and total
19 proforma salaries, and a table.

20 And the second page providing a payroll
21 analysis. And there are some handwritten notes at the
22 bottom of this page. And I believe, Ms. Parker, you
23 identified those notes as having been made by you; is
24 that correct?

25 THE WITNESS: Yes.

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1 JUDGE SCHAER: And I think it's appropriate to
2 have those notes in the record, but I do like to reflect
3 that on the record so people who look at these later
4 know you can look at those numbers as well.

5 So with those numbers, I am going to admit the
6 two-page document that is now Exhibit 27.

7 (EXHIBIT ADMITTED)

8 MS. TENNYSON: Thank you.

9 Q BY MS. TENNYSON: At this point I would like to
10 refer to your testimony, Ms. Parker, at page 8.
11 Referring specifically to the testimony that starts at
12 line 14 you state, "The dividends that are paid to the
13 individual shareholders represent the return on
14 investment for the shareholder." Do you see that?

15 A Yes.

16 Q And dividends are only one component of the
17 shareholder's return; isn't that true?

18 A For a regulated company, yes.

19 Q And you then go on to say that the dividends
20 belong to the investors, and the individual shareholders
21 fully expect to pay the taxes from the dividend
22 distribution on their individual income tax return.
23 Isn't that statement also true for the sub S corporation
24 shareholder?

25 A I am not understanding the question, because

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1 sub S corporations, I have never seen them distribute a
2 dividend.

3 Q But distribution for the return on the
4 investment for the shareholder, wouldn't the shareholder
5 expect to pay their taxes from the distributions they
6 received from the corporation for a sub S?

7 A Again, I am confused. In the case of Rainier
8 View, that's exactly what they are doing. They are
9 paying their taxes from the distribution of equity of
10 retained earnings.

11 Q Maybe I can rephrase it. The shareholders have
12 the discretion, and they can do what they want with the
13 income from the subchapter S corporation, correct? They
14 are not directed to do anything in particular with those
15 earnings?

16 A I don't think there's a direction from anyone,
17 a statute or anything, that says that they don't have
18 any control over that net income, no. They have the
19 ability to do as they wish.

20 However, as an operational standpoint, water
21 companies usually have -- are encouraged to reinvest
22 their equity. If they were to distribute all of their
23 income, as other S corporations in industries that are
24 not regulated do, such as the retail industry, they
25 would be chastised by the Commission, I can only

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1 imagine, to not retain any equity in the Company to fund
2 growth and to continue operations. I see constantly the
3 companies chastised for not having enough equity
4 investment in their business, in their water company
5 business.

6 But that statement is true. You can distribute
7 that income however you wish, within limitations,
8 obviously.

9 Q Let's go on to your testimony at page 9.
10 Starting at line 9 you discuss distributions, and you
11 state your view that it would be unreasonable to expect
12 the shareholder to pay the entire cost of the income
13 liability if there was no distribution of income. And
14 as you have indicated, it's common that all of the cash
15 is tied up in operations, and no distribution occurs.
16 Do you see that?

17 A Yes.

18 Q Now, if the Company retains the earnings in the
19 Company, does that increase the shareholder's equity?

20 A Yes. Their retained earnings is increased.
21 That would be an equity increase.

22 Q Now, in that instance, when the earnings are
23 retained in the Company, the value of the shareholders'
24 stock increases; isn't that true?

25 A Their basis in the stock increases, yes.

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1 Q Now, I just want to make sure I have an
2 understanding here. On page 9, line 17, you talk about
3 it's common that all cash of operations is tied up in
4 operations, no distribution of income occurs, and
5 Rainier View follows this pattern.

6 Now, Mr. Ault testified for the Company that a
7 distribution of the amount equal to the income tax does
8 occur for Rainier View Water. Is it your testimony no
9 distributions are made, or that there is some form of
10 distribution, but not a full distribution?

11 A A distribution representing the amount of
12 income tax owed on the utility operation is distributed
13 to the shareholder through a payment directly to the US
14 Treasury for its estimated taxes.

15 Q Turning to page 10 of your testimony, starting
16 at line 10, you asked a question -- you are asked if you
17 agree with Mr. Kermod's testimony, but you don't really
18 answer this "yes" or "no."

19 I mean, do you agree, "The Commission has not
20 issued an order or decision approving rates for an S
21 corporation that include recovery of income taxes, other
22 than the tax on CIAC"?

23 MR. FINNIGAN: You changed the question
24 slightly, but --

25 MS. TENNYSON: I have?

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1 MR. FINNIGAN: -- other than noting that, I
2 have no objection.

3 THE WITNESS: Because this issue has never come
4 up in a rate-making setting, I am not aware of any order
5 that addresses the income tax issue for S corporations.
6 So in that essence, I would agree.

7 But I go on to state that though that order
8 doesn't exist, there's an order that accepts the
9 settlement agreement on the CIAC portion, which is the
10 same type of issue that we're discussing here.

11 Q BY MS. TENNYSON: So then you would agree that
12 the order that you reference -- and I believe that
13 reference is on page 11, line 7. Is that the order you
14 are talking about?

15 A Yes.

16 Q That third supplemental order in U-88-2294-T,
17 that allowed the Company to collect taxes on the value
18 of the contributed plant, correct?

19 A Yes.

20 Q In answering my earlier question, you said the
21 issue has never come up, of the taxes or the imputed
22 income taxes, I gather, for an S corporation.

23 And are you referring to while you were
24 employed by the Commission?

25 A I am referring to while I was employed by the

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1 Commission, and the knowledge I gained there while on
2 staff as to prior years. And I have not seen an order
3 since that time indicating that this has been an issue.

4 Q And you use your Exhibit JMP-3 to support your
5 testimony in this point; is that correct?

6 A Yes.

7 Q Are you aware of later rate case filings by --
8 than the one listed for Meadows Water Company?

9 A No, I am not aware of that. It was not given
10 to me when I requested all recent rate case workpapers
11 in the last three years.

12 Q Are you aware of a recent case involving
13 Pacific Water?

14 A Again, if it's not listed, I was not provided
15 with those workpapers.

16 Q Do you know or do you recall the approximate
17 time frame when you made those requests?

18 A I requested the day after Christmas, 2001, a
19 Records Management Search on that, which it did not
20 provide me with that information. And then I don't know
21 the exact date of Mr. Finnigan's request for information
22 that came through as a Data Request, but it was within
23 the last couple of months.

24 Q Mr. Finnigan's request, you don't really know
25 if it was a Public Records Request or Data Request,

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1 do you?

2 A I do not recall.

3 Q Page 12 of your testimony, you discuss the
4 accrual of deferred taxes. And at line 18 you state you
5 routinely recreated this tax amount for small water
6 companies to deduct this from rate base, when rate
7 proceedings are involved.

8 Have you calculated the deferred tax amount for
9 Rainier View Water?

10 A No, I have not.

11 Q You said it's routinely done, and it's not very
12 difficult. What information would you need to do that?

13 A I would need a copy of their tax return. The
14 calculation I am talking about is the basic calculation
15 that was taught to me as, on Staff, to determine
16 deferred calculation.

17 And based on a training manual that was around
18 at that time, the most simple approach would be to
19 compare accumulated depreciation per tax and accumulated
20 depreciation book, and calculate the deferred tax effect
21 on that. And use that as the rate base deduction.

22 It's a rather simplified approach, but I think
23 that it represents a very close calculation to the
24 effect of the deferred taxes on rate base.

25 Q To your knowledge, has anyone at Rainier View

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1 Water performed that calculation?

2 A To my knowledge, no, I don't believe it's been
3 done. We discussed it, and I do not know if it was
4 completed or not.

5 Q If you were to perform that, do you know how
6 many hours it might take you to do that?

7 A A quick analysis that I was talking about might
8 take less than an hour. A more detailed approach --

9 Q But it's not something we would want you to sit
10 on the stand and do?

11 A No, it's probably not something you would want
12 me to sit on the stand to do. It's further complicated
13 in recent years since the repeal of the tax on
14 contributed plant that occurred in 1997. So there's a
15 little bit more to it.

16 But this particular company has only been in
17 existence since about 1990, and it should not be a
18 large, time-consuming calculation.

19 Q Referring to your testimony at page 13,
20 starting at approximately line 13, and you list several
21 other companies. Can you tell us which, if any of these
22 companies, incurred any income tax, other than the tax
23 on the contributed plant?

24 A (Reading document.) I did not review their tax
25 returns, so I cannot answer that question. My review

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1 was strictly what was provided to me in a data request,
2 and what I was able to ascertain in my visit to the
3 Commission on December 26th.

4 Q And, again, data requests, you are referring to
5 the Public Records Request?

6 A The Public Records Request.

7 Q Sorry. We do have a distinct difference here.

8 A Okay.

9 Q Going to page 14, at line 12 there, you state,
10 "The shareholder bears the cost without any benefit,
11 ending up subsidizing the rate payer for this cost."
12 Do you see that?

13 A Yes.

14 Q Could you explain how it is that the tax code
15 has eliminated a level of taxation for S corporations,
16 yet according to you, there's no difference between the
17 tax burden that should be borne by the rate payer
18 between a C corp, and an S corp?

19 MR. FINNIGAN: I object to the form of the
20 question; specifically the word "eliminated."

21 JUDGE SCHAER: Ms. Tennyson, objection to the
22 form.

23 MS. TENNYSON: I can rephrase.

24 JUDGE SCHAER: Thank you. Go ahead.

25 Q BY MS. TENNYSON: Now, with a C corporation, as

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1 Ms. Ingram testified, you have a tax on the corporation.
2 And then when there's any dividends distributed to the
3 shareholder, they would be taxed again at the
4 shareholder level, correct?

5 A Yes.

6 Q And for an S corporation, what we have is
7 a taxation only at the shareholder level, based on the
8 amount of income the Company has, correct?

9 A Correct.

10 Q So with that structure, then, can you explain
11 why you believe there should be no difference, or there
12 is no difference in the tax burden that should be borne
13 by the rate payer for a C corporation, and an S
14 corporation?

15 A Well, in this case, Rainier View is operating
16 as though they were a C corporation. They are not
17 distributing to the shareholder anything other than the
18 income tax effect of those earnings. So they are
19 operating as though they were a C corporation.

20 In comparison to entities that I advise that
21 are not regulated water companies, we routinely look at
22 their income structure to make sure that what they are
23 charging is enough to cover what they consider a
24 reasonable return on their time and services and
25 investment, as well as the income tax effect on their

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1 tax return.

2 So I don't think that there's a business entity
3 out there that does not take income tax into effect when
4 they are making a determination of what their charge
5 should be. It's a cost of doing business. And in that,
6 I don't think that the choice of business entity,
7 whether or not they make this S selection, should have
8 any bearing on what the rate-making effects are in
9 determining rates for a water company.

10 The water company is, even though they are an S
11 corporation and could distribute that revenue, they are
12 in a regulatory structure, which would penalize them if
13 they did so.

14 And so they have made a choice not to
15 distribute that income, and they don't have any -- in
16 that regard, they have no discretionary income, which
17 dividends would be. Which, again, makes them very much
18 like a C corporation which retains all of its equity.

19 Q Now, in your answer, you said the regulatory
20 structure which would penalize the Company if they
21 distributed all the income.

22 That assumes, then, the owner is not investing
23 equity in the Company, correct?

24 A Correct.

25 Q And during my cross examination of Ms. Ingram,

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1 she referred a question to you. I don't know if you are
2 prepared to answer it.

3 But the tax, or the disadvantages of the C
4 corporation structure, in her testimony, she referred to
5 the tax code having created the S corporation structure
6 to avoid the disadvantages of a corporation. Can you
7 tell us what those disadvantages might be?

8 A When the S corporation was formed, the greatest
9 disadvantage of the corporate structure was a higher
10 corporate tax rate than that which was incurred by an
11 individual. Since that time, the tax rates have
12 flipped, so that the highest individual tax rates are
13 higher than the highest corporate tax rates. So in that
14 regard, it's -- the corporate tax structure is at a
15 disadvantage, the C corporation.

16 For the average S corporation, it's much more
17 difficult to get the income, the net income to the
18 shareholders through -- you would have to declare a
19 dividend in order to get it to -- distribute income
20 through the shareholders; thereby creating the tax
21 disadvantage of the double tax.

22 Now, your question is referring to the tax
23 disadvantages of a C corp, and so the income
24 distribution for a nonregulated entity is a lot easier
25 through an S corporation than it is through a C

0290

1 corporation.

2 If you look back in history, it's my belief
3 that this small business S corp -- subchapter S
4 corporation was created to enable small companies who
5 would otherwise be a sole proprietorship, or a
6 partnership, to incorporate and get the limited
7 liability aspects of the corporation without having to
8 have such a strict structure that is required of the C
9 corporations.

10 MS. TENNYSON: I have no further questions of
11 this witness.

12

13 EXAMINATION

14

15 BY JUDGE SCHAEER:

16 Q Ms. Parker, I have a clarifying question about
17 Exhibit 51. Under Column 602, Officers' Salaries, the
18 last line shows this case, and shows a total of \$76,440.
19 Do you see that?

20 A Yes.

21 Q Is it not part of the Company's case that there
22 should be an adjustment near PA-1 that would add \$6,818
23 to this account?

24 A I would have to review the Company's testimony
25 again to ascertain that. My exhibits were prepared

0291

1 simultaneously, and we may have --

2 Q Well, would you accept, subject to check, that
3 at the proforma level, the Company had proposed \$83,258?

4 A That was 83,000 --

5 Q \$83,258.

6 A I would accept that, subject to check.

7 JUDGE SCHAER: Thank you. That's all I have.

8 Any redirect, Mr. Finnigan?

9 MR. FINNIGAN: Do you have any questions
10 related to the Bench?

11 MS. TENNYSON: No.

12 MR. FINNIGAN: Just a couple.

13

14 REDIRECT EXAMINATION

15 BY MR. FINNIGAN:

16 Q Would you turn to Exhibit 52, please?

17 A (Complies.)

18 Q There's a column labeled Proforma Federal Tax.
19 Do you see that column?

20 A Yes, I do.

21 Q Could you tell me where you got that
22 information?

23 A Those came directly from the results of
24 operations that were provided to the Company under that
25 public request.

0292

1 Q So for each line, it comes from the results of
2 operations, page 4, of the Company as indicated?

3 A Yes.

4 Q You were asked questions concerning if there's
5 an increase in retained earnings, does that increase the
6 value of the shareholders' stock. Do you remember that
7 question?

8 A Yes.

9 Q Is there a difference between a stock basis and
10 the value of shares on a fair market value basis?

11 A There's a definite difference. The basis of
12 stock is simply what that investor has originally
13 invested, plus what they have been taxed on through
14 retained earnings calculations in the S corporation
15 return, what it's flowed through, and they have been
16 taxed on the retained earnings.

17 The valuation on a fair market value depends on
18 the actual value of the plant, I would imagine. In the
19 case of a traded company, it has only to do with public
20 perception. In the case of a small business, it would
21 have to do with -- the fair market value would have to
22 do with the fair market value of the plant and fixtures
23 and equipment that the Company has.

24 Q Can the fair market value be either higher or
25 lower than the basis in this stock?

0293

1 A Yes, it can be. In fact, I have seen wide
2 fluctuations in fair market value and closely held
3 companies in just a matter of years.

4 MR. FINNIGAN: Thank you.

5 JUDGE SCHAER: Is there anything further for
6 this witness?

7 MS. TENNYSON: I don't believe so.

8 JUDGE SCHAER: Thank you for your testimony,
9 and let's go off the record for a moment to allow the
10 next witness to take the stand.

11 (Discussion off the record.)

12 JUDGE SCHAER: Let's go back on the record
13 after a brief recess to allow people to move about the
14 room and get organized for going forward.

15 Mr. Finnigan, did you have any further
16 witnesses, or anything else to present on your direct
17 case?

18 MR. FINNIGAN: That completes the witnesses on
19 behalf of the Company.

20 JUDGE SCHAER: Ms. Tennyson, do you wish to
21 call any witness at this time?

22 MS. TENNYSON: Yes. I would call Danny Kermode
23 to the stand.

24 JUDGE SCHAER: Mr. Kermode, raise your right
25 hand.

0294

1 DANNY P. KERMODE,
2 produced as a witness in behalf of the Staff, having been
3 first duly sworn, was examined and testified as follows:

4

5 JUDGE SCHAER: Would you like me to identify
6 Mr. Kermode's exhibits, Ms. Tennyson?

7 MS. TENNYSON: Yes, please.

8 JUDGE SCHAER: I am going to identify
9 Mr. Kermode's testimony, which is labeled DPK-T-1, as
10 Exhibit T-53. His exhibit DPK-2, which is a Proforma
11 Income Statement, Exhibit 54. His Exhibit DPK-3 as his
12 Adjustment RA-4 Salaries and Wages, as Exhibit 55. His
13 Exhibit DPK-4, which is the Shareholder's Return on
14 Investment, as Exhibit 56.

15 His Exhibit DPK-5, which is labeled as
16 Adjustment PA-5, Commercial Automobile Coverage Premium,
17 as Exhibit 57. His Exhibit DPK-6, which is labeled
18 PA-9, Fixed Assets, as Exhibit 58.

19 His Exhibit DPK-7, which is labeled Long Term
20 Debt at Year End, as Exhibit 59. DPK-8, identified as
21 Capital Structure Cost of Equity, as Exhibit 60. And
22 his Exhibit DPK-9, identified as Debt Service Coverage
23 Ratio, as Exhibit 61.

24 Go ahead, Ms. Tennyson.

25 MR. FINNIGAN: Your Honor, if I might, I think

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1 I am suffering from low blood sugar, but I have got
2 mixed up and lost track somewhere between.

3 JUDGE SCHAER: Is it the list that you need?

4 MR. FINNIGAN: The list -- I have the exhibits,
5 but I have somehow misnumbered them as I went through.

6 JUDGE SCHAER: Well, let's go off the record
7 for a moment.

8 (Discussion off the record.)

9 JUDGE SCHAER: Let's be back on the record.

10 While we were off the record a copy was made of
11 an exhibit list, so we can all keep organized.

12 Go ahead, Ms. Tennyson.

13

14 DIRECT EXAMINATION

15 BY MS. TENNYSON:

16 Q Spell your name for the reporter.

17 A Danny P. Kermode, K-e-r-m-o-d-e.

18 Q And where are you employed?

19 A I am employed with the Washington Utility
20 Transportation Commission as a Regulatory Analyst III.

21 Q And have you submitted prefiled testimony and
22 exhibits in this case, which have been marked as
23 Exhibits T-53 and 54 through 61?

24 A Yes, I have.

25 Q And you also submitted an errata to your

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1 testimony; is that correct?

2 A Yes, ma'am.

3 Q Now, in your identification of yourself, or
4 your title, you used a different term than shows up on
5 the errata. Can you clarify for us, what is your
6 current title?

7 A There was a change in the titles, I believe, in
8 November. So there was a bit of confusion. I am now a
9 regulatory analyst III. On line 9 of my testimony, I
10 indicate I am a program consultant. That's the old
11 title.

12 Q Thank you. With the errata that's been
13 submitted, the clarification you just made, were these
14 exhibits prepared -- let's start with that question.

15 Were these exhibits prepared by you, or under
16 your supervision?

17 A Yes, they were.

18 Q And with the clarifications and the errata that
19 you have submitted to the testimony and exhibits, if I
20 were to ask you these questions today, would the answers
21 you have provided be the same?

22 A Yes, they would.

23 MS. TENNYSON: And I would offer admission of
24 Exhibits T-53 and Exhibits 54 through 61.

25 JUDGE SCHAER: Any objection?

0297

1 MR. FINNIGAN: There's just one exhibit I would
2 like to withhold to see if, after I examine Mr. Kermode
3 on that particular exhibit, whether I have an objection
4 or not. I won't know until I ask him, and that's DPK-4,
5 Exhibit 56. I have no objection to the other exhibits.

6 JUDGE SCHAER: Okay. Exhibit T-53, 54, 55, and
7 Exhibits 57 through 61 are admitted.

8 (EXHIBIT ADMITTED)

9 JUDGE SCHAER: And I will reserve ruling on
10 DPK-4.

11 MR. FINNIGAN: Thank you, Your Honor.

12 MS. TENNYSON: The witness is available for
13 cross.

14 MR. FINNIGAN: Do we want to mark the cross
15 exhibits?

16 JUDGE SCHAER: We could do that.

17 Mr. Finnigan, would you describe your cross
18 exhibits and identify those, and have them ready to go
19 if you should decide to offer any of them?

20 MR. FINNIGAN: You should have a package of
21 exhibits that starts out with a listing of them. And
22 the first one is a photograph of a Chevy C35. I will
23 note that the description says it's a one-ton cab and
24 "classis" instead of "chassis." It is, indeed, probably
25 a classic, but the word should be "chassis."

0298

1 The next exhibit is a two-page --

2 JUDGE SCHAER: Excuse me. I was writing down
3 numbers. But let's mark that, the picture, as Exhibit
4 62 for identification.

5 MR. FINNIGAN: The next exhibit are two
6 schematic illustrations.

7 JUDGE SCHAER: I will mark that for
8 identification as Exhibit 63.

9 MR. FINNIGAN: The next exhibit is two pages of
10 discussion out of ValueLine concerning the water utility
11 industry.

12 JUDGE SCHAER: I'll mark that as Exhibit 64.

13 MR. FINNIGAN: The next exhibit is the
14 Company's Response to Staff Data Request No. 2.

15 JUDGE SCHAER: I will mark that as Exhibit 65.

16 MR. FINNIGAN: The next exhibit is the case of
17 Bluefield versus the Public Service Commission.

18 JUDGE SCHAER: I will question you as to why
19 that's an exhibit.

20 MR. FINNIGAN: It doesn't need to be. I will
21 have some questions. It just might be handy for people
22 to have as a reference.

23 JUDGE SCHAER: I can put it under the
24 it's-easy-to-have-it-and-refer-to-it rule; otherwise,
25 it's not something that needs to be an exhibit.

0299

1 MR. FINNIGAN: I just thought it might be
2 helpful for people to have.

3 JUDGE SCHAER: We will go ahead and mark that
4 as Exhibit 66 for identification.

5 MR. FINNIGAN: The next exhibit is several
6 pages related to Mr. Kermode's DCF Analysis.

7 JUDGE SCHAER: Is that in this case?

8 MR. FINNIGAN: Yes.

9 JUDGE SCHAER: Mark that as Exhibit 67 for
10 identification.

11 MR. FINNIGAN: The next item is a news release
12 from -- concerning one of the companies used by
13 Mr. Kermode.

14 JUDGE SCHAER: Mark that as Exhibit 68 for
15 identification.

16 MR. FINNIGAN: The next is a printout of the
17 web page for another of the companies used by
18 Mr. Kermode in his analysis.

19 JUDGE SCHAER: And that is the Middlesex Water
20 Company?

21 MR. FINNIGAN: Correct, Your Honor.

22 JUDGE SCHAER: Mark that as Exhibit 69 for
23 identification.

24 MR. FINNIGAN: The next exhibit is the material
25 that is on file at the Records Center concerning the

0300

1 Rainier View 1996 rate case.

2 JUDGE SCHAER: I will mark that as Exhibit 70
3 for identification.

4 MR. FINNIGAN: The next exhibit is a portion of
5 the material that is in the Records Center file
6 concerning the Rainier View 1994 rate case.

7 JUDGE SCHAER: Mark that as Exhibit 71 for
8 identification.

9 MR. FINNIGAN: The next exhibit is similar to
10 the prior, except it relates to the 1993 rate case.

11 JUDGE SCHAER: I may have misspoken. On the
12 1994 case, it's marked as Exhibit 71. I am not sure if
13 I gave it a number or not. For the 1993 rate case, that
14 would be Exhibit 72.

15 Go ahead.

16 MR. FINNIGAN: And finally, the material -- the
17 last of these exhibits is related to the 1992 rate case.

18 JUDGE SCHAER: And I will mark that for
19 identification as Exhibit 73.

20 I am going to suggest that we take our lunch
21 recess at this time, and then come back and start fresh
22 with Mr. Kermode.

23 How long would counsel like for lunch? Was an
24 hour and 15 minutes long enough yesterday, or do you
25 need more time?

0301

1 MR. FINNIGAN: It was adequate. May I suggest
2 we come back at 1:00?

3 JUDGE SCHAER: That would be fine for me. Is
4 that okay for you, Ms. Tennyson?

5 MS. TENNYSON: That's fine, yes.

6 JUDGE SCHAER: We will go to lunch and
7 reconvene at 1:00.

8 We are off the record.

9 (Lunch recess taken.)

10 JUDGE SCHAER: Let's be back on the record
11 after our lunch recess.

12 And at this point, I had asked for a check-back
13 on a couple of items. And I believe that you,
14 Mr. Finnigan, have some more information about responses
15 to the Bench Request that was made yesterday?

16 MR. FINNIGAN: Yes, I do. As I indicated off
17 the record, the Company is in the middle of its 2001
18 audit. We expect that we can provide the information
19 for both 2000 and 2001 within two weeks.

20 JUDGE SCHAER: I am going to mark that
21 information, or I am going to assign an exhibit number
22 to that information of Exhibit 74. And unless there's
23 some concern expressed, I am going to admit that into
24 the record, so when we receive that information, you can
25 make use of it.

0302

1 Is there any concern about that?

2 MS. TENNYSON: There's no concern with the
3 request. And we don't know what the response is going
4 to be, but I don't anticipate we will have any problems
5 with it.

6 JUDGE SCHAER: Well, let's treat this like a
7 subject to check. If something does come up that causes
8 you concern, you can inform the Bench and Mr. Finnigan
9 of your concerns.

10 MS. TENNYSON: Okay.

11 (EXHIBIT ADMITTED)

12 JUDGE SCHAER: Thank you. And then your
13 client, Ms. Tennyson, was checking on whether there
14 would be a need for a public hearing. And it's my
15 understanding we're hoping to have some feedback by
16 mid-afternoon on that?

17 MS. TENNYSON: That's correct.

18 JUDGE SCHAER: Is there anything more before we
19 start with questions?

20 MR. FINNIGAN: Yes, there is.

21 MS. TENNYSON: In the interest of reducing the
22 issues necessary for decision, Staff -- after reviewing
23 the Company's rebuttal testimony and exhibits, the Staff
24 will agree to accept the Company's figure with the
25 proforma adjustment for the electric expense adjustment;

0303

1 that is, the Company's proforma adjustment No. 7,
2 Staff's would be No. 3. So we will accept the Company's
3 number on that.

4 In excess of precaution with our concern about
5 electricity rates, we don't know where they might go.
6 So we will take the higher number.

7 And in addition, Staff has agreed to drop its
8 restating adjustment No. 10 after reviewing the rebuttal
9 testimony.

10 JUDGE SCHAER: And that is --

11 MS. TENNYSON: I don't know what -- precisely
12 what it refers to. The dollar amount is \$5,433 that
13 Staff had removed.

14 MR. FINNIGAN: I believe the adjustment is
15 labeled "Adjust CIAC."

16 MS. TENNYSON: I believe that's correct. Staff
17 will remove that adjustment from its proposal.

18 JUDGE SCHAER: Very good. Anything else before
19 we start with Mr. Kermode?

20 (No response.)

21 JUDGE SCHAER: Go ahead, Mr. Finnigan.

22

23 CROSS EXAMINATION

24 BY MR. FINNIGAN:

25 Q Good afternoon, Mr. Kermode.

0304

1 A Good afternoon.

2 Q I want to start with some general discussion,
3 if you will. You have been with the Commission for a
4 number of years; is that correct?

5 A Five.

6 Q And you have been assigned to the water section
7 of the Commission's activities, is that correct, for
8 that period of time?

9 A Water -- transportation, also.

10 Q And during that time, you have reviewed the
11 operations of any number of water companies that have
12 made filings in front of the Commission?

13 A Yes, sir.

14 Q So you have a general familiarity with the way
15 in which water companies operate?

16 A Yes.

17 Q In fact, you have -- prior to joining the
18 Commission, you had other experience that involved
19 regulated water companies?

20 A I worked about 15 years in Arizona,
21 specifically with regulated water companies.

22 Q Would you please look at what has been marked
23 as Exhibit 63, please?

24 A (Complies.) Yes.

25 Q And I will take the blame for the art work, but

0305

1 would you agree that that represents a simplistic view,
2 but a view of an operating water company?

3 A Yes.

4 Q And let's assume that the developments that are
5 marked there, one through five, that they each serve 100
6 customers for purposes of our discussion.

7 A Okay.

8 Q A water company would need to have a well that
9 has a certain amount of acre feet, and a certain demand
10 component to it that would have to be adequate to serve
11 those 500 customers; is that correct?

12 A That's my understanding, yes.

13 JUDGE SCHAER: Let's go off the record for a
14 moment.

15 (Discussion off the record.)

16 JUDGE SCHAER: Let's go back on the record.

17 While we were off the record we were examining
18 a pounding sound from the hallway, with no success in
19 solving what it was.

20 Q BY MR. FINNIGAN: And to get that water out of
21 the ground, out of the well, you need a pump of
22 sufficient size to move the well water out of the well
23 and into the storage tank; is that correct?

24 A That's correct.

25 Q And you would need to size your storage tank so

0306

1 it was sufficient to meet the demands of those 500
2 customers; is that correct?

3 A Yes. That would be wise.

4 Q And in addition, at least in Pierce County, you
5 would have to be able to meet the Pierce County fire
6 flow requirements for those developments; is that
7 correct?

8 A That's correct.

9 Q And then, obviously, you would need a
10 distribution main that would come from the tank to get
11 to those developments?

12 A Correct.

13 Q Once you have engineered your basic system, you
14 would need that basic system in place whether you were
15 serving five developments as depicted here, or three
16 developments. If two of them weren't on line, you would
17 still need the same distribution system, for example, to
18 serve the area in which you are providing service?

19 A So if I understand what you are saying, you are
20 expecting five developments to come on line. We
21 designed the system for five, but only three are up at
22 one time. The engineered system for the five would be
23 in place. Yeah, that would be logical.

24 Q And you couldn't readily adjust the size of the
25 tank to fluctuate downward with fewer customers; is that

0307

1 correct?

2 A No.

3 Q And once you have your water rights and well in
4 place, again, it's pretty difficult to get that
5 downsized to meet the needs of fewer customers than what
6 it is engineered for?

7 A It probably wouldn't be reasonable to expect
8 that, yeah, somebody go back and retrofit it to be
9 smaller.

10 Q Could you go to the second page of the
11 schematics. And in case you are confused, what this
12 shows is an interior design for development, showing
13 service to 10 residential lots. Does that appear to be
14 the case?

15 A Yes, it looks good. Yes.

16 Q And do you understand that a 12-inch
17 distribution main is pretty standard for providing
18 service in Pierce County?

19 A I will accept that.

20 Q Do you understand that to provide fire flow,
21 you either need a six-inch looped distribution system
22 within a development, or an eight-inch deadend system
23 that doesn't exceed a certain length?

24 A Those are engineering things, so I will accept
25 that. I believe I have seen that, so it makes sense,

0308

1 yes.

2 Q And we have here, we have 10 service lines
3 coming off of this distribution system. Can you see
4 that?

5 A Yes.

6 Q If you only had a residential customer at one
7 of those 10, you would still need the distribution plant
8 to serve that one customer?

9 A Yes.

10 Q Are you generally familiar with the types of
11 regulatory requirements faced by water companies in
12 terms of meeting the purity and pressure requirements
13 for water systems?

14 A I interface with it as I am doing audits, but I
15 haven't sat down and studied deeply. But, yes, I am
16 aware of them.

17 Q Do you have a sense that those requirements are
18 increasing?

19 A Yes.

20 Q Are you aware that the Department of Health has
21 enacted a new cross-control requirement?

22 A Yes.

23 Q And that they have certain operator
24 certifications now in place that they didn't have
25 before?

0309

1 A Yes.

2 Q Are you aware that there are new standards
3 related to arsenic in the water that are on their way?

4 A Yes.

5 Q Are you aware that there are new requirements
6 related to radon contamination of water supplies?

7 A Yes, and related testing.

8 MS. TENNYSON: Your Honor, Mr. Kermode doesn't
9 have anything about this in his testimony. If it's
10 helpful to the Bench, I guess it can continue. But I
11 guess without more information about where this is
12 going, if it's leading to anything --

13 MR. FINNIGAN: It is.

14 MS. TENNYSON: It may be information within
15 Mr. Kermode's expertise, but it's certainly not part of
16 his direct testimony.

17 JUDGE SCHAER: Mr. Finnigan, are you going
18 somewhere?

19 MR. FINNIGAN: Yes. What I wanted to do was
20 set a baseline about certain things, and then it will
21 relate to Mr. Kermode's testimony as we go through.

22 JUDGE SCHAER: I am finding this helpful
23 background, the types of things that Mr. Kermode or
24 someone in his job interfaces with, and the factors that
25 are involved with the water company. And I am going to

0310

1 let the questioning continue.

2 MS. TENNYSON: Thank you.

3 Q BY MR. FINNIGAN: In addition to these sorts of
4 requirements related to water pressure and purity, there
5 are other requirements imposed on a company, even by
6 this Commission; isn't that correct?

7 A Yes.

8 Q Included among those is -- excuse me just a
9 moment.

10 Included among those is a requirement to
11 furnish and supply service that's safe, adequate,
12 efficient; is that correct?

13 A That's correct.

14 Q And if the Commission finds that the Company is
15 falling down in that area, they have a statutory
16 authority to order the Company to make improvements?

17 A That's my understanding, yes.

18 Q And would you agree that there's a statutory
19 requirement that the Company supply -- excuse me, supply
20 service for anyone who may be reasonably entitled to
21 that service?

22 A I believe that's true.

23 Q Now, in this case you went out and visited the
24 Rainier View Company facility; is that correct?

25 A Twice, I believe.

0311

1 Q And you also reviewed their books and records
2 here at the Commission?

3 A Yes.

4 Q Were you able to form an impression as to
5 whether or not the Company is a well-managed company?

6 A Yes, I did.

7 Q What is that impression?

8 A I found that they were well managed.

9 Q And the Company, from a relative perspective,
10 has relatively few customer service complaints here at
11 the Commission; is that correct?

12 A From my review in the recent years, yes.

13 Q Did you have an opportunity to go back 10 years
14 or so?

15 A Yeah, I looked at some older stuff.

16 Q Would it be safe to say that the Company has
17 improved its operations over that period of time?

18 A No question, yes.

19 Q The Company's rates that it charges for
20 service, would you characterize those as among the
21 lowest of the regulated companies? By regulated, I mean
22 regulated by this Commission.

23 A They are in the -- I didn't do any type of
24 chart, but I know from gut feeling they are mid to
25 lower.

0312

1 Q Now, as I understand your testimony in this
2 case related to Mr. Richardson's salary --

3 A Yes, sir.

4 Q I believe it's at page 10 at the top, the very
5 top of page 10. Do you see your testimony?

6 A Yes, I do.

7 Q And your recommendation is that Mr. Richardson
8 have a salary which recovers \$41,548 from current rates?

9 A Yes.

10 Q Do I also understand your testimony correctly
11 that the way you arrived at that figure was to look
12 primarily at the rate of inflation from 1993 to the year
13 2000?

14 A That's correct.

15 Q Mr. Kermode, are you familiar with the
16 publication from this Commission called the 1995 Digest
17 of Utility Cases?

18 A Yes, I am.

19 Q Is that a tool you have used?

20 A I have used it. It's on my computer. I look
21 at it. I have researched it, yeah.

22 Q Would you agree that the Commission has stated
23 that they may allow wages that are rewards for good
24 performance and increases in productivity to be
25 recovered in rates?

0313

1 A I wasn't aware of that in the Digest.

2 Q Let me give you -- the reference, in
3 particular, is the WUTC versus Pacific Power & Light
4 Company, Docket U8602.

5 Now, I want to jump back for just a moment to
6 your testimony at the beginning, pages 1 and 2. And you
7 clarified one confusion on the start, and that's your
8 job title.

9 A Uh-huh.

10 Q At page 1, line 16, you indicate that you are a
11 CPA?

12 A Yes.

13 Q Do you practice as a CPA outside of the
14 Commission?

15 A I do a couple of things on the side, and I use
16 my license. I am a licensed CPA, yes.

17 Q So on average, you put in more than an
18 eight-hour day?

19 A Yes.

20 Q And you are also a certified financial planner;
21 is that correct?

22 A Yes.

23 Q Do you practice as a CFP?

24 A No, I don't.

25 Q But that is a training that you went through?

0314

1 A And took the test and all of that, so, yes.

2 Q Looking at page 3 of your testimony, line 24,
3 you indicate there that you include a recommended rate
4 design?

5 A I think that was an errata.

6 Q That's what I was checking. I don't have it
7 changed in mine, so I was wondering.

8 A It was meant to be changed.

9 JUDGE SCHAER: Mine shows it was changed, if
10 that helps you.

11 MR. FINNIGAN: I misstepped myself.

12 JUDGE SCHAER: If you need to look at the
13 errata, I have it available.

14 MR. FINNIGAN: That's okay. Thank you.

15 Q BY MR. FINNIGAN: On page 4, line 16, you refer
16 to revenue sensitive adjustments?

17 A Yes, sir.

18 Q Can you describe for me what you mean by a
19 revenue sensitive adjustment?

20 A B&O tax would be one. As revenues go up, the
21 B&O tax goes up. As the revenues go down, the B&O tax
22 goes down. It's directly related to revenue.

23 Q You don't have a separate column in your
24 results of operations for what you call revenue
25 sensitive adjustments, do you?

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1 A No, I don't.

2 Q Going over to page 5, line 13, you use the term
3 "to a basis acceptable for rate-making purposes"?

4 A Yes, sir.

5 Q By that, do you mean a basis acceptable to you?

6 A No. I would say it's -- I would be adjusting
7 it to a basis that I believe is acceptable for rate
8 making. I am not the final -- I am not -- I have
9 understanding of what is acceptable for rate making. So
10 I adjust it to that.

11 Q And that's what I was trying to get at, is this
12 was based upon your understanding of what is acceptable?

13 A Yes, sir.

14 Q Would you go over to page 6, please?

15 A (Complies.)

16 Q Line 13, you use the term "misleading."
17 Did you mean to imply that the Company was attempting to
18 intentionally mislead the Commission?

19 A No. And I couldn't think of any other word, to
20 tell you the truth. But, no, I did not expect that.

21 Q Okay. In fact, the Company has been
22 forthcoming in the course of this case with you, hasn't
23 it?

24 A Yes.

25 Q And I have got the same sort of question with

0316

1 the use of the word "failure" on line 16. You didn't
2 mean to imply that there was any improper motive on the
3 Company's part?

4 A No. No.

5 Q Would you agree that this case does involve
6 some precedential issues?

7 A Yes, sir, I do.

8 Q Looking at page 7, lines 8 through 13, you are
9 talking about the treatment surcharge revenue?

10 A Yes.

11 Q Would you agree that the \$190,201 relates to
12 prior years' expenses removed as a result of the
13 accounting order, rather than principal payments?

14 A I am sorry. Say that again?

15 Q That the amount that is removed, the \$190,201,
16 is pursuant to the accounting order that was entered for
17 Rainier View, a recognition of prior years' expenses,
18 but not principal payments?

19 A I believe that's true.

20 Q What is your understanding of a stand-by fee?

21 A Versus ready to serve, in contrast?

22 Q Just in its abstract, what is your
23 understanding of what a stand-by fee is?

24 A Stand-by fee is a fee that a Company -- and not
25 one regulated by this Commission -- would assess a

0317

1 customer for them merely being there. They might have a
2 main that goes in front of the house, no service line
3 out to the house. They charge the lot owner a stand-by
4 fee. Versus ready to serve, we look at where the
5 Company has the true ability to serve, and they are
6 ready to serve. That's the contrast between the two.

7 Q You have been here in the hearing room
8 throughout this proceeding, haven't you?

9 A Yes, sir.

10 Q So you were here when Mr. Fisher testified?

11 A Yes, sir.

12 Q And you heard Mr. Fisher testify concerning how
13 the Company operates with the developers under its
14 contracts with those developers?

15 A Yes.

16 Q And you heard him testify that there are
17 several steps that the Company goes through before they
18 will accept the system from the developer?

19 A Yes.

20 Q And that they -- that in a development, the
21 first thing that goes in is the storm sewer, and the
22 sewer lines. And then that's followed by the water
23 mains?

24 A I didn't hear him say that. But, okay, I will
25 accept that.

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1 Q And then following when the water mains are
2 installed, that they will pressure test them, and then
3 shut them down.

4 A Yeah, I think he called it -- I forget the term
5 that he had.

6 Q Well, I will get to that in just a second.

7 A Okay.

8 Q And then after that, the power lines and
9 telephone lines and cable TV lines go in.

10 A Again, I didn't hear him testify to that, but I
11 understand.

12 Q And then the roads go in?

13 A Yes.

14 Q And then I think this was the term you were
15 looking for, that he then testified they go back then
16 and "heat up the system"?

17 A Yes. Yes, sir.

18 Q Is that the term you were thinking of?

19 A I believe so, yes.

20 Q If we go to your testimony at page 8, lines 15
21 through 23.

22 A Yes.

23 Q Would you agree with me that if, under these
24 development contracts, you have 10 lots, like we had on
25 the illustration, one of which is serving a customer and

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1 the other 9 are still in the hands of the developer,
2 that we would still need that plant, the distribution
3 plant to serve that one customer?

4 A Yes, sir.

5 Q And the Company would be incurring the
6 depreciation expense for that plant, because it's
7 serving that one customer?

8 A Yes, sir.

9 Q And are you familiar with the Commission's
10 interpretive statement issued in 1993 regarding revenue
11 elements in jurisdictional thresholds for water
12 companies?

13 A Off the top of my head, I don't remember. It
14 sounds familiar, but I don't --

15 Q Maybe if I hand you a copy, maybe that might
16 help.

17 JUDGE SCHAER: I think that would be
18 appropriate to look at what you are talking about. You
19 may approach.

20 THE WITNESS: (Reading document.)

21 Q BY MR. FINNIGAN: Have you seen this
22 interpretive statement before?

23 A Yes, I have.

24 Q Did you consider this interpretive statement in
25 arriving at your recommendation as to whether or not

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1 ready to serve charges should be included or excluded as
2 operating revenue?

3 A Since it refers to stand-by fees, no.

4 Q Would you agree it also talks about other types
5 of fees, other than stand-by fees?

6 A Yes.

7 Q But I assume the bottom line is that you did
8 not have this interpretive statement in mind when you
9 reached your recommendation?

10 A Yes, because I didn't think it was applicable.
11 Yes.

12 Q Did you consider the interpretive statement one
13 way or the other in arriving at your recommendation?

14 A No, I didn't.

15 JUDGE SCHAER: Mr. Finnigan, had you considered
16 putting this in as an exhibit, or --

17 MR. FINNIGAN: If you would like it as an
18 exhibit. I have gone back and forth about the things
19 that should be exhibits because they are Commission
20 orders, but I would have --

21 JUDGE SCHAER: We have been following the rule
22 of maximum convenience, that something that is labeled
23 with an exhibit label and is in the book is easier to
24 find. But I would want to hear from both of you as to
25 whether or not you think it would be useful to have in.

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1 MS. TENNYSON: I would object to it, because
2 this is an interpretation for revenue elements that
3 would be considered in determining whether a company is
4 jurisdictional. So in this case, the stand-by fees that
5 might be charged, there might be one customer on a
6 system, and 15 others paying stand-by fees but not
7 receiving water.

8 This says you don't consider the fact that
9 those people are paying those stand-by fees in
10 determining whether or not there's 100 customers or
11 whether the Company meets the dollar requirements for
12 Commission jurisdiction. It's not relating to how one
13 counts revenues at the Company, or how one accounts for
14 revenues once they become jurisdictional.

15 JUDGE SCHAER: Well, I don't know if
16 Mr. Finnigan would want to offer it. I was just curious
17 about how to treat it at this point.

18 MR. FINNIGAN: Well, if we want to mark it as
19 an exhibit, I can ask the witness a couple more
20 questions and then we can see whether or not it should
21 be admitted. It seems to me it's a Commission order,
22 and either of us are free to use it for what it's worth,
23 whether it's an exhibit or not.

24 JUDGE SCHAER: Certainly. As I said, this is
25 the rule of thumb we have followed earlier in the case;

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1 things that were technically not needing to be exhibits,
2 but might be handy if they were, could be put in. We
3 have another order. We have a court case. I wouldn't
4 be ruling that this is somehow relevant material
5 evidence. I would just be putting it in as an easy way
6 to find it.

7 So I don't know. But if you are going to
8 continue to object, since I've said literally -- we will
9 not admit it. So that's where we are, I think.

10 Q BY MR. FINNIGAN: Mr. Kermode, would you agree
11 that in coming up with this interpretive statement this
12 Commission was trying to get at what would be operating
13 revenue so that it could use operating revenue to
14 provide the jurisdictional threshold for water
15 companies?

16 A Yes, I would. And I believe -- now I know why
17 I recognize this interpretation. Is when we rewrote the
18 water rules, we had taken this and used -- basically I
19 don't know if you would say "override" it, but the new
20 WAC took this place. And we became more specific, and
21 tried to differentiate such as the stand-by charge here.
22 The stand-by charge in this statement is very loosely
23 used, where in the WAC, we focused very much on if water
24 is being provided.

25 And my understanding of the ready to serve is

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1 that the water is being provided to the developer.

2 Q You anticipated my next question, and that is
3 in fact, the Commission has adopted a rule that talks
4 about revenue for jurisdictional thresholds; isn't that
5 correct?

6 A That's correct.

7 Q And that's WAC 480.110.255?

8 A Correct.

9 Q You are hoping?

10 A I am taking your word for it.

11 Q You don't have it memorized, but that sounds
12 familiar?

13 A It does.

14 Q Would you agree with me that in determining
15 jurisdiction in subsection 3 of that rule, the
16 Commission states that it does not consider customers
17 who do not receive water, such as customers who have
18 paid -- and two of the items that are listed are
19 stand-by charges and ready to serve charges?

20 A And do not receive water, correct.

21 Q Such as customers who have paid stand-by
22 charges, and ready to serve charges?

23 A Right.

24 Q So the Commission is treating ready to serve
25 charges in the same category as stand-by charges for

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1 purposes of its new rule?

2 A As far as jurisdiction, yes.

3 Q Would you look at your testimony, please, at
4 page 8, lines 9 and 10?

5 A (Complies.) Yes, sir.

6 Q And the sentence starts, "The proper
7 accounting." Do you see that sentence?

8 A Yes, sir.

9 Q There are several functions or services a water
10 company performs that could be performed by another
11 entity; isn't that correct?

12 A Could you give an example?

13 Q Sure. For example, testing of water to see
14 what might be in that water, that doesn't have to be
15 done by a water company?

16 A That is correct.

17 Q And testing of pressure in a water system
18 doesn't have to be done by the water company, does it?

19 A That's correct.

20 Q And providing treatment for water doesn't
21 necessarily have to be done by the water company, does
22 it?

23 A That is right.

24 Q And, in fact, there's a whole category of
25 functions that are performed by water companies, called

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1 SMAs in the state, that are not regulated water
2 companies; is that correct?

3 A That's correct.

4 Q Moving to the question that is at the bottom of
5 page 8, and moving to the top of page 9.

6 A (Reading document.)

7 Q Do you have that in front of you?

8 A Yes, sir.

9 Q Did you discuss this with Ms. Ingram?

10 A No, I didn't.

11 Q Did you discuss this with Ms. Parker?

12 A No, I did not.

13 Q Would you go now to page 14, line 9?

14 A I am there, yes.

15 Q And also line 8 -- page 14, lines 8 and 9.

16 A Yes, sir.

17 Q You agree that the B&O tax on utility revenue
18 is 5.029 percent; is that correct?

19 A That's correct.

20 Q If I look at your Exhibit DPK-2, if I look at
21 your restating adjustment RA-2, which is the ready to
22 serve revenue; is that correct?

23 A Yes, sir.

24 Q That's \$154,066?

25 A Yes.

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1 Q And I look at RA-11, which is, as I understand
2 it, is the B&O tax related to that dollar figure?

3 A Yes.

4 Q And that's \$2,735?

5 A That's correct.

6 Q Now, admittedly, lawyers doing math is an
7 issue. But when I multiply \$154,066 by the B&O tax
8 rate, I get a sum of \$7,748?

9 A That's correct.

10 Q Why is your RA-11 \$2,735?

11 A Well, I found one error, and I had deducted bad
12 debt expense of \$53,000. Therefore, that was an offset
13 of \$2,700 that I had reduced the calculated amount by
14 that, by \$2,700.

15 The remaining difference is the ready to serve
16 revenue had already been taxed at the service rate that
17 was 1.5 percent. So I took the difference between the
18 5.029 and 1.5 percent. That percentage difference is
19 3.529. Multiplied the 3.529 times the 154, you get
20 \$5,437. That should be my adjustment with the
21 elimination of the bad debt error.

22 Q And I was going to get you there. So we both
23 agree that the number for RA-11 should be \$5,437?

24 A Yes, sir.

25 Q Okay. Thank you, Mr. Kermode. You have been

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1 with the Commission since approximately 1997; is that
2 correct?

3 A Yes, sir.

4 Q This may predate you a little bit, so I will
5 ask you if you know: do you know if the Commission in
6 the past has used the term stand-by fee and ready to
7 serve interchangeably?

8 A No, I don't know.

9 Q I would like to move to another subject now.
10 At page 10, now line 19, I believe this
11 includes -- this is the lease expense for the Company.

12 A Yes, sir.

13 Q The Company provided you with information
14 concerning the amount of space that it currently
15 occupies today; is that correct?

16 A That's correct.

17 Q And it currently occupies 4,100 square feet
18 with an additional 3,906 feet of common space, and
19 15,000 square feet of outdoor storage and parking --

20 A I could check --

21 Q Does that sound familiar? Sure, if you have an
22 easy way to check, that would be great.

23 A (Reading document.) Could you repeat the
24 question?

25 Q Sure. 4,160 square feet of office space, with

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1 an additional 3,906 feet of common space, and 15,000
2 square feet of office storage and parking.

3 Do you want to accept that, subject to check,
4 if it's not appearing in your records quickly?

5 A I have the 4,000, but I don't have the other
6 common area.

7 Q Okay. I think you indicated an answer to an
8 earlier question that you had gone to the Company site
9 at least twice?

10 A Yes, sir.

11 Q And you are aware of Mr. Fisher's testimony in
12 this case that they try and make efficient use of space,
13 and it's not a gold-plated operation?

14 A Yes, I am aware of that.

15 Q Would you agree with Mr. Fisher's
16 characterization?

17 A Yes, I do.

18 Q Did you do any comparison of the number of
19 square feet that the Company used -- of office space
20 used in 1990 with the year in 2000?

21 A No, I didn't.

22 Q Did you compare the number of employees the
23 Company had in 1990 versus the number of employees the
24 company had in the year 2000?

25 A I believe I did, but I don't think I used it

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1 for anything. I think I looked at it.

2 Q But you didn't use it for purposes of, for
3 example, this adjustment?

4 A Right.

5 Q Would you please look at Exhibit 62. While you
6 were at the Company's operations, did you have an
7 opportunity to look at their vehicles?

8 A I didn't explicitly go out and review their
9 vehicles.

10 Q Would you accept, subject to check, that
11 this is the Chevy C35 referred to in your testimony?

12 A Yes.

13 MS. TENNYSON: How would he check that? He has
14 to go to the Company again.

15 MR. FINNIGAN: Well, yes, I mean that's one way
16 that -- that's certainly one way of doing it.

17 THE WITNESS: I will accept that that is a
18 picture of the C35 Chevy. Of course, I want to make a
19 differentiation that my testimony -- I talk about the
20 cost associated with this. I meant -- I did not say
21 that he should be assigned this vehicle.

22 Q BY MR. FINNIGAN: But you would agree that it's
23 realistic in using a surrogate that the surrogate ought
24 to be a vehicle that is useable for the purpose for
25 which it is intended?

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1 A I looked in the listing of the assets. I
2 looked at the highest priced vehicle, other than the
3 Navigator. And so I was looking at a value, and I said,
4 "This cost is the highest value that they paid for a
5 vehicle," so used that value or that cost as a
6 surrogate.

7 I truly didn't look at the vehicle itself, look
8 up and see if that pickup truck was equivalent to the
9 Navigator. I was looking at what they have spent on
10 vehicles, and what the highest cost of that vehicle,
11 other than the Navigator, was.

12 Q If the Company had a one-ton vehicle that was
13 equipped for operating in the field, and that cost was
14 \$40,000, would you have used that as your surrogate?

15 A I don't know. I don't know.

16 Q My question prior to this one was, wouldn't you
17 agree that everything else being equal, the surrogate
18 should be a vehicle that is capable of being used for
19 the use to which it is put?

20 A I guess that's why I went back. I think my
21 surrogate was the value, and not the vehicle. So for
22 the value, I guess, I could equate that to a lot of
23 vehicles out there, and find one that was appropriate.
24 If that answers it.

25 Q But that's not what you did?

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1 A No.

2 Q In Mr. Fisher's testimony, he's proposed a
3 compromise on this issue?

4 A Yes, sir.

5 Q Is it my understanding that Staff is unwilling
6 to accept that compromise?

7 A That's correct.

8 MR. FINNIGAN: Before I get too far out in
9 space, I would like to offer Exhibits 62 and 63.

10 MS. TENNYSON: I would object to the offer of
11 Exhibit 62. It may be the vehicle referred to, but I
12 believe Mr. Kermode's testimony indicates he was not
13 suggesting this as a replacement vehicle for
14 Mr. Richardson to drive. But he used the cost of this,
15 supposedly this vehicle from the Company's records to
16 determine a value that would be included in his proposal
17 for the amount of the vehicle cost that Mr. Richardson
18 should be allowed.

19 JUDGE SCHAER: Mr. Finnigan, the objection
20 appears to be material.

21 MR. FINNIGAN: Yes. Mr. Kermode accepted this
22 as a picture of the vehicle. He described -- and
23 obviously we have a different theory as to what is the
24 approach used in determining an appropriate vehicle
25 expense. And I think this picture helps illustrate why

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1 we believe the use of this particular surrogate, as
2 suggested by Mr. Kermode, is inappropriate.

3 Obviously, as I have suggested, the appropriate
4 surrogate, if one was needed, is to go out and look at a
5 vehicle that would serve the same function as the
6 vehicle for which the surrogate is being proposed.

7 JUDGE SCHAER: Any brief response?

8 MS. TENNYSON: I believe that Mr. Finnigan has
9 mischaracterized Mr. Kermode's testimony. His testimony
10 is clear that he substituted the cost of the vehicle.
11 If the Company wants to seek another surrogate of that
12 cost, that's some other issue, or a different cost.

13 But Mr. Kermode did talk only to the cost, and
14 he said, "I took these costs, put these other costs in,"
15 not that he recommends that this be the vehicle used by
16 the president.

17 JUDGE SCHAER: I am going to admit Exhibit 62.
18 I also heard Mr. Kermode accept this picture of the
19 vehicle that is described in his testimony, and I
20 understand very clearly what his reasoning is, because
21 he described it to us.

22 But I do find it useful to put a picture with a
23 number in order to make something more real in your
24 mind, and that's the reason I will admit this.

25 (EXHIBIT ADMITTED)

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1 JUDGE SCHAER: Did you have any objection to
2 Exhibit 63?

3 MS. TENNYSON: No.

4 JUDGE SCHAER: That document is also admitted
5 then.

6 (EXHIBIT ADMITTED)

7 JUDGE SCHAER: Go ahead, Mr. Finnigan.

8 Q BY MR. FINNIGAN: Mr. Kermode, generally I am
9 not very subtle, but I did overlook something and I need
10 to ask you to back up. So if you back up to page 10 of
11 your testimony.

12 A Okay.

13 Q And I am looking at lines 12 through 17.

14 A Yes, sir.

15 Q Did you hear Mr. Fisher testify yesterday that
16 approximately 60 percent of those costs were related to
17 the issues that are in the present case of the income
18 tax and ready to serve charges?

19 A Yes, I heard that.

20 Q Is Staff willing to accept 60 percent of that
21 amount as an appropriate adjustment in this case?

22 A At this time, probably not.

23 Q Moving to page 19.

24 A (Complies.)

25 Q And actually, I think we're going to skip that.

0334

1 Let's move to page 24.

2 JUDGE SCHAER: I am sorry. Did you say page
3 24?

4 MR. FINNIGAN: Yes.

5 JUDGE SCHAER: Thank you.

6 Q BY MR. FINNIGAN: Would you look at Exhibit 65,
7 please.

8 A (Complies.) Yes.

9 Q Do you recognize this as a Data Request
10 propounded by the Staff, and the Answer from the
11 Company?

12 A Yes, I do.

13 Q And do you agree that the response given here
14 is consistent with Mr. Fisher's testimony yesterday, as
15 to the methodology the Company uses?

16 A Quite, frankly, this -- Mr. Ault's description
17 was a little cleaner, and I understood it a little
18 better than this one here.

19 Q Well, you do agree that Mr. Fisher testified
20 that the Company uses an allowance method with
21 adjustments to actual? I am asking you what his
22 testimony was.

23 A Yes. Yes. Yes.

24 Q You would agree that as revenue increases, the
25 amount of bad debt would increase as well?

0335

1 A Yes, sir.

2 Q Let's move to page 29, line 2.

3 A (Complies.)

4 Q The discussion here concerns the Company's
5 proposed adjustment for a piece of litigation; is that
6 correct?

7 A That's correct.

8 Q Would you agree with me that the Commission
9 has, on prior occasions, allowed companies to recover
10 the expense of litigation, particularly in defense of
11 litigation, over an appropriate amortization period?

12 A The cases I reviewed, usually they were
13 extraordinary cases.

14 Q In fact, Rainier View itself has been
15 authorized to do that in prior years when faced with a
16 litigation where it defended itself?

17 A That is correct.

18 Q And North Bainbridge Water Company was allowed
19 a similar treatment; is that correct?

20 A That is also correct.

21 Q And Paradise Lake Country Club was allowed
22 similar treatment; is that correct?

23 A I did not review that case.

24 Q Let me give you the docket No. UW-0002800.

25 MS. TENNYSON: The company again?

0336

1 MR. FINNIGAN: Paradise Lake Country Club.

2 Q BY MR. FINNIGAN: And if you need, I have the
3 Staff memo for that, or you can look at it --

4 A That would be fine.

5 Q -- later.

6 A Yeah.

7 Q Would you go to page 32 of your testimony,
8 please?

9 A Yes, sir.

10 Q Would you look at Exhibit 64, please.

11 A (Complies.) Yes, I have that.

12 Q And these are -- well, can you identify what
13 Exhibit 64 is?

14 A It appears to be a sheet, probably a ValueLine
15 related to the water industry.

16 Q And you would agree that you provided these
17 sheets to me as part of your workpapers?

18 A Yes.

19 Q Would you look down in the text to the bottom
20 right of the first page of Exhibit 64, and could you
21 read that statement, please, where -- under the title
22 "Investment Advice"?

23 A "The water utility stock in this review are not
24 timely for investment in the coming 12 months." Just
25 that sentence?

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1 Q You can finish it up, so it's in context.

2 A "Nevertheless, a few of these stocks, such as
3 American Water Works and Philadelphia Suburban, have
4 above-average safety ranks, attractive dividend yields
5 that might appeal to conservative investors."

6 Q What is your understanding when ValueLine says
7 a particular industry is not timely for investment?

8 A When compared to all the other industries that
9 they are following, there's other industries that if
10 somebody is ready to invest, they would suggest that
11 they invest in those other industries, not this
12 industry.

13 Q And would you agree with me that investment
14 advisors are really quite skilled at soft-speak?

15 A No. I think that it depends on the personality
16 of the advisor, to tell you the truth about.

17 Q But you would agree with me that what this
18 advisor is saying is you ought to invest elsewhere?

19 A Knowing investor advisors, what he's saying is
20 this is a riskier investment than the rest of the
21 portfolio that you can put together. And he's advising
22 the client that the risk is higher, and that the person
23 should be aware of that higher risk. That's my
24 experience with investment advisors, quite frankly.

25 Q The last portion of that statement, that "two

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1 of the stocks have above-average safety ranks and
2 attractive dividend yields that might appeal to the
3 conservative investor," do you see that?

4 A Yes, sir.

5 Q In this case a conservative investor is one who
6 is looking for dividends that they can use, perhaps, to
7 supplement their retirement income?

8 A An older, less risk, adverse-type investor,
9 yes.

10 Q Would you go to page 2 of this exhibit?

11 A (Complies.) Yes.

12 Q And would you look down under investment advice
13 in the lower right-hand corner again?

14 A Yes.

15 Q Would it be safe to say that his advice hasn't
16 changed between May and August?

17 A Yes.

18 MR. FINNIGAN: I will offer Exhibit 64.

19 JUDGE SCHAER: Any objection?

20 MS. TENNYSON: No.

21 JUDGE SCHAER: That document is admitted.

22 (EXHIBIT ADMITTED)

23 Q BY MR. FINNIGAN: Would you look at Exhibit 66,
24 please.

25 A (Complies.) Yes.

0339

1 Q Would you look at page 6 of that exhibit.

2 A (Complies.) I am at page 6.

3 Q And there's a mark on the right-hand column,
4 which is the area I would like you to take a look at.

5 JUDGE SCHAER: Did you put that mark on there,
6 Mr. Finnigan?

7 MR. FINNIGAN: I did, just so it would be
8 easier to find.

9 JUDGE SCHAER: Thank you.

10 THE WITNESS: (Reading document.)

11 Q BY MR. FINNIGAN: Let me know when you have had
12 a chance to go through it.

13 A Yes.

14 Q Now, in your testimony at page 32, lines 9
15 through 18, I think -- would I be correct that you are
16 attempting to paraphrase the elements of what is
17 required under the Bluefield case?

18 A And the Hope case.

19 Q And would you agree with me that in looking at
20 this material on page 6, there's an additional element
21 that you don't have on page 32? And that is,
22 specifically, the language that is in the same general
23 part of the country?

24 A What's interesting about that is this case is a
25 1923 case. The Hope case is 1940, something, came out.

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1 And if you look at the Hope case, the same wording, the
2 same area, the regional part has dropped. They have
3 changed the wording to say something -- "commensurate
4 with the returns of investment, and other enterprises
5 having corresponding risks."

6 So in that time period it appears that the
7 regional portion has dropped out, because our
8 industry -- or our financial world has increased from a
9 national -- from a regional to a national, to frankly,
10 right now, international economy. So that's why I did
11 not include it.

12 Q But you agree that insofar as you cite to
13 Bluefield as authority, that Bluefield included that
14 fourth element?

15 A Yes.

16 Q Would you look now at Exhibit 67, please.

17 A Yes.

18 Q And do you recognize Exhibit 67?

19 A Yes. It's a schedule that I produced.

20 Q Is it true, then, that page 2 is a page out of
21 your workpapers?

22 A Yes, it is.

23 Q And I am not trying to trick you, so I will
24 identify for you that page 3 is an update to that
25 company that was not in your workpapers, but from the

0341

1 same source?

2 A That's correct, yes.

3 Q And the next three pages are also pages out of
4 your workpapers?

5 A Yes. I see my mark on the side, so yes.

6 Q And that other than the one page that
7 post-dates your page 1 of that Exhibit 67, these were
8 materials that you used in arriving at the analysis on
9 page 67?

10 A Actually, Exhibit 67, page 1, used an older
11 ValueLine. If you look at the lower left-hand corner,
12 it has ValueLine, August 4. I had redone the cost
13 capital, and used the older cost capital instead. So I
14 actually have updated the schedule.

15 Q Well, I guess I have to ask a question. I
16 propounded a data request to the Staff asking for your
17 workpapers; is that correct?

18 A That was correct.

19 Q And page 1 of Exhibit 67 is from your
20 workpapers tab 78; is that correct?

21 A (Reading document.)

22 Q If you look on it, it has the marking on the
23 lower right-hand corner?

24 A Yes, sir.

25 Q And as you will see behind that page in your

0342

1 workpapers, came the two -- or one of the water utility
2 industry items; is that correct?

3 A That's correct.

4 Q And then two pages in further, you have another
5 water utility industry page; is that correct?

6 A How many pages are we in now?

7 Q Your workpapers, we're on your fourth page.

8 A Yes.

9 Q And then we have the various ValueLine pages
10 that comprise Exhibit 67; is that correct?

11 A That's correct.

12 Q So you did not provide, in response to the data
13 request, the ValueLine information that went into this
14 calculation; is that correct?

15 A Well, actually you did get what was in my
16 workpapers. That was what I thought was actually in
17 there. It's only upon review, going back with the
18 exhibit, that I noticed that there was a mismatch.

19 MS. TENNYSON: If we might go off the record
20 for a minute so we can compare, so we have the same
21 thing?

22 JUDGE SCHAER: Let's go off the record for a
23 moment.

24 (Discussion off the record.)

25 JUDGE SCHAER: Let's be back on the record.

0343

1 While we were off the record, Counsel had
2 discussion about some information.

3 Go ahead, please.

4 Q BY MR. FINNIGAN: In looking at Exhibit 67,
5 this is your DCF analysis?

6 A That's correct.

7 Q And if you go down to the schedule marked On
8 Market Weighted Cost of Capital?

9 A Yes.

10 Q Of the stocks that you used, one of them
11 comprises over 50 percent of the component for that
12 analysis; is that correct?

13 A That's correct.

14 Q And that's the American Water Works?

15 A Yes, sir.

16 Q And, in fact, as we have identified, this is an
17 August 2000 run. And in 2001 its weighting actually
18 increased; isn't that correct?

19 A That's correct.

20 Q And, in fact, if you will go to page -- the
21 third page of this exhibit, Exhibit 67, you will see an
22 updated February 1, 2002 ValueLine reference for
23 American Water Works?

24 A Yes, sir.

25 Q And if you will go down under the analysis, you

0344

1 will see that American Water Works has been sold?

2 A I believe I read that, so, yes. And you can
3 see there was, yes.

4 Q Since American Water Works has been sold to a
5 foreign corporation and is no longer publicly traded,
6 wouldn't you agree that it should not be used in the DCF
7 analysis?

8 A Now that it's out of the marketing current one
9 that I would try to run, it would not be in there, yes.

10 Q Would you go to the page marked Philadelphia
11 Suburban?

12 A Yes, sir.

13 Q And there's the little box that is labeled
14 "Business," sort of in the middle of the page.

15 A Yes.

16 Q If you go over to the right-hand portion of
17 that box, there's a note that the company known as
18 Vivendi --

19 A Yes.

20 Q -- controls 16.9 percent of the company?

21 A Yes.

22 Q Do you know who Vivendi is?

23 A I believe it's a French company.

24 Q Is it a French water company?

25 A It's a French water company, yes.

0345

1 Q Would you agree that when one stockholder owns
2 a substantial portion of a company, and that stockholder
3 is in the same business, that that calls into question
4 whether or not the held company should be included in
5 the DCF analysis?

6 A Well, 16 percent, 17 percent, I would probably
7 say, no, they don't have enough control. Again, of
8 course, it depends on how the stock is disbursed. But
9 17 percent -- at 50 percent, well, I am not even sure of
10 that. Maybe if they had more control. I guess, I don't
11 think I would necessarily agree. If it was still on the
12 market, even to a lesser degree, I believe that the
13 shares would still try to reflect what the expectation
14 of those buyers that are buying at the time, what they
15 expect as far as return.

16 Q Philadelphia Suburban serves approximately 2
17 million customers; is that correct?

18 A It would make sense. I can't find it.

19 Q It's in that same little box.

20 A Thank you. Yes, 2 million.

21 Q Would you go to Exhibit 68, please.

22 JUDGE SCHAER: And, again, that's 68 for
23 identification?

24 MR. FINNIGAN: Yes.

25 JUDGE SCHAER: Thank you.

0346

1 THE WITNESS: Yes, I have that.

2 Q BY MR. FINNIGAN: Can you see from this exhibit
3 that E'town has been acquired by another foreign water
4 company?

5 A Yes.

6 Q So, again, you would agree that if it's no
7 longer publicly traded, it should not be included in the
8 DCF analysis?

9 A Yeah. If it's not publicly traded, you can't
10 get information on it at all.

11 Q And going to Exhibit 69 for identification.

12 A Yes, I have it.

13 Q Do you recognize this as the website for this
14 company, for Middlesex Water Company?

15 A I am trying -- oh, I mean, I am sorry. I was
16 looking for the locator. It looks a little different.
17 But, yes, I will accept it.

18 Q Would you agree that Middlesex Water Company,
19 on its own, serves 57,000 customers?

20 A I would say it says, "The Middlesex system has
21 57,000 customers."

22 Q And apparently there are either additional
23 systems, or additional subsidiaries that add to that
24 customer count?

25 A That's correct.

0347

1 Q And in addition, Middlesex Water Company
2 wholesales water?

3 A That would make sense, yes.

4 Q Rainier View doesn't have any wholesale water
5 customers, does it?

6 A No.

7 MR. FINNIGAN: I will offer Exhibits 64, 66 --
8 yeah, 64, 66, 67, 68, and 69.

9 JUDGE SCHAER: So you are not going to offer
10 65? And I believe 64 has been admitted.

11 MR. FINNIGAN: Okay.

12 JUDGE SCHAER: So we're looking at Exhibits 66
13 through 69.

14 Any objections, Ms. Tennyson?

15 MS. TENNYSON: No.

16 JUDGE SCHAER: Those documents are admitted.

17 (EXHIBITS ADMITTED)

18 Q BY MR. FINNIGAN: Would you agree with me from
19 a general perspective that the risk premium required by
20 investors increases during periods of uncertainty?

21 A Yes, as uncertainty increases, risk increases.

22 Q And that is true whatever the source of the
23 uncertainty is; is that correct?

24 A Yes.

25 Q Would you go to Exhibit 33, I believe it is.

0348

1 A Could you describe that?

2 Q It's the National Bank for Cooperatives Master
3 Loan Agreement.

4 A Yes, I have it.

5 JUDGE SCHAER: I am showing 32 as --

6 MR. FINNIGAN: 33.

7 JUDGE SCHAER: Oh, thank you. Okay.

8 Q BY MR. FINNIGAN: Do you have that?

9 A I am sorry. Yes, I do.

10 Q You are familiar with Mr. Fisher's testimony in
11 this matter concerning Rainier View's relationship with
12 Cobank?

13 A His written testimony, yes.

14 Q Would you agree that the use of Cobank as the
15 source of debt for the Company has been a benefit to the
16 customers of Rainier View?

17 A Yes, I would.

18 Q Would you please look at page -- I am sorry for
19 the delay -- page 9, please.

20 A I have page 9.

21 Q And to understand page 9, I think you also have
22 to start, unfortunately, on loan documents. They
23 sometimes get very long, but I think you have to go back
24 to page 6 to see what the start of the section is. This
25 is section 11.

0349

1 A Yes.

2 Q And that's "Affirmative Covenants"?

3 A Yes.

4 Q And it says, "Unless otherwise agreed to in
5 writing by Cobank, while this agreement is in effect the
6 borrower agrees to" -- and there's a laundry list of
7 affirmative covenants; is that correct?

8 A That's what it says.

9 Q If you go over to subparagraph M, on page 9.

10 A "M" as in "Mike"?

11 Q Yes. Entitled "Use of Surplus Revenues."

12 A Yes.

13 Q Would you take a moment to read that, please.

14 A (Reading document.) I am done.

15 Q Would you agree that the Company has promised
16 in writing to Cobank as an affirmative covenant that it
17 will not use net income except to reduce obligation to
18 creditors or invest in capital expenditures directly
19 related to the ability to provide service to its
20 customers?

21 A Yes.

22 Q And would you agree that if Rainier View failed
23 to live up to that obligation, that would constitute an
24 event of default under this agreement?

25 A I am going to hedge, because I think that's a

0350

1 legal opinion.

2 Q Why don't you take a look at section 13 on page
3 11, subsection "C" as in "Charlie."

4 A (Reading document.) Okay. Yes.

5 Q So the answer to my prior question was "yes"?

6 A Yeah. Reading the contract, it explicitly says
7 that.

8 Q Okay. Thank you. Would you agree that there's
9 always a concern about setting the cost of debt for
10 regulated companies at a point in time as being either
11 too high or too low?

12 A Say that again? I am sorry.

13 Q Well, since I can't remember exactly what I
14 said --

15 A Could you rephrase that?

16 Q Would you agree that in establishing the cost
17 of debt for a regulated company, there is always a
18 concern that if you use a point in time, that that cost
19 will either be too high or too low?

20 A I think the concern, as you've stated it, isn't
21 at that point in time is it too high or low? The
22 question is, what will happen in the future as to the
23 results a year or two years from now? Will they
24 overearn or underearn?

25 Q Have you heard of the concept of a snapshot

0351

1 picture of debt?

2 A I have heard the concept. I know snapshot, and
3 I know that concept.

4 Q So you haven't heard that term used in
5 relationship to the setting of the cost of debt?

6 A No, I don't think so.

7 Q In this case you express a concern that the
8 Company has to be able to cover its interest -- excuse
9 me, its debt service ratios that are set forth in the
10 Cobank loan?

11 A Yes.

12 Q And I take it a source of that concern is if
13 the Company fails to cover those ratios, it could be
14 declared in default under those loans?

15 A Yes.

16 Q Have you calculated whether or not the Company
17 can cover its debt coverage ratios if the cost of debt
18 that it has to pay to Cobank is at 7 percent, on
19 average, for the year in which rates will be in place?

20 A No.

21 Q Have you done any calculations of whether it
22 will cover the debt coverage ratios, at any figure,
23 other than the one you are recommending in this case?

24 A Yes. I figured it for the results of the --
25 proposed by the Company. I looked at the results of the

0352

1 proforma statement before effective rates. I believe
2 those are the ones I looked at.

3 Q For your recommendation, did you do any
4 sensitivity analysis to determine what would happen if
5 debt costs were to rise over the course of the year in
6 which rates would be in place?

7 A No, I did not.

8 Q If we were at a point in time where the cost of
9 debt was near or at its historical high, wouldn't the
10 Commission be concerned about embedding that particular
11 cost of debt in rates?

12 A My experience is that's a factor that is
13 weighed, that I have not personally seen the Commission
14 take an action to -- like the scenario you had, to
15 reduce the cost of debt before the cost of debt had
16 actually decreased.

17 Q So what you are saying is that you haven't seen
18 the Commission use an average cost of debt for the test
19 period, as opposed to the highest cost of debt, where
20 that highest cost of debt occurred at the close of the
21 test period?

22 A I have not.

23 Q Turning to a different but related subject, are
24 you aware that the Commission has, on a large number of
25 occasions, used a hypothetical capital structure?

0353

1 A Yes, I am.

2 Q And would you agree with me that the
3 principal -- that the principal uses in establishing a
4 capital structure is to balance the safety of that
5 capital structure with the cost of that capital
6 structure?

7 A Yes.

8 Q And just so we're clear for the record,
9 although I think everybody around here knows what this
10 means, by safety, we mean a safe capital structure is
11 one that has higher levels of equity than another
12 capital structure?

13 A Yes. A safe one would indicate a high level of
14 equity.

15 Q So to take that to the extreme, the safest
16 capital structure would be 100 percent capital equity?

17 A Yes, but expensive.

18 Q So that gets the other side. The expense part
19 is to include a component of debt, because debt is
20 generally less expensive than equity; is that correct?

21 A That's correct.

22 Q If this company came in with a capital
23 structure that was 75 percent equity, would you be
24 recommending that that -- that a hypothetical capital
25 structure be used?

0354

1 A Yes, I would.

2 Q Generally, doesn't the Commission want capital
3 structures to be no more than 60 percent equity?

4 A I think financial theory has an area between 40
5 and 60. It can be in between there without overweighing
6 either side.

7 MR. FINNIGAN: This might be an appropriate
8 time for an afternoon break. I have, I think, a couple
9 of areas to go, and not a whole lot more time, I think.

10 JUDGE SCHAER: The way to get the break is to
11 tell me you will have fewer questions if we break.

12 MR. FINNIGAN: That is certainly my intent.

13 JUDGE SCHAER: Let's take our afternoon break
14 at this point. We will be back at ten minutes after
15 3:00.

16 We're off the record.

17 (Brief recess taken.)

18 JUDGE SCHAER: Let's be back on the record
19 after our afternoon recess.

20 Did you have additional questions,
21 Mr. Finnigan?

22 MR. FINNIGAN: I do have a couple of additional
23 areas.

24 JUDGE SCHAER: Go ahead, please.

25 Q BY MR. FINNIGAN: Mr. Kermodé, did you hear

0355

1 Ms. Parker's testimony earlier today concerning the
2 deferred tax issue related to depreciation?

3 A Yes, I did.

4 Q Would you agree with me that if you wanted to
5 do a full analysis of that issue, that in addition to
6 timing differences that result in decreases to rate
7 base, there will be timing differences that result in
8 increases to rate base?

9 A Yes.

10 Q Would you agree that for purposes of tax timing
11 differences, there can be taxable income for tax
12 reporting purposes that is greater than taxable income
13 reported for regulatory purposes?

14 A Quite frankly, that's probably the norm, yes.

15 Q Did you look at the tax return related to
16 Rainier View's operations for the test year?

17 A Yes, I did.

18 Q And would you agree with me that for -- that
19 based on that return, that the tax depreciation exceeded
20 booked depreciation in 2000, for the calendar year 2000
21 by the sum \$213,302?

22 A \$213,302?

23 Q Correct.

24 A Yes.

25 Q Would you agree that for tax reporting purposes

0356

1 the revenue from -- the taxable revenue from Rainier
2 View exceeded the taxable income for regulatory purposes
3 by \$310,659?

4 A Could you say that again?

5 Q Sure. And it may be easier for me to break it
6 down into component parts.

7 Would you agree that there was an amount
8 reported for tax reporting purposes for hook-up fees in
9 the amount of \$186,384?

10 A Yes, I would agree.

11 Q And that there were taxes recorded for CIAC in
12 the amount of \$121,708?

13 A I have 131, but --

14 Q Is it --

15 A (Looking at document.)

16 MS. TENNYSON: If I may raise a procedural
17 matter, I believe the tax return was provided to us on a
18 confidential basis. Do you have a concern --

19 MR. FINNIGAN: Not these numbers. Thank you
20 for asking, but not these numbers.

21 THE WITNESS: You said 121?

22 Q BY MR. FINNIGAN: Yes.

23 A I am sorry. I had a typo. Yes, it's \$121,708.

24 Q And that's on the same concept for amortization
25 of surcharges in the amount of \$2,567?

0357

1 A That's correct.

2 Q And that that total is the \$310,659 that I
3 started this line of questioning with?

4 A And that was the \$10,000 difference that I
5 identified. Yes, that's correct.

6 Q Let's move to the last area for my portion of
7 the afternoon, and this is income tax expense.

8 A (Complies.)

9 Q Mr. Kermodé, is it your intent -- and I don't
10 mean you personally. Is it the intent of the Commission
11 Staff to have the Commission dictate the form of entity
12 that may operate as a regulated water company?

13 A No, it's not.

14 Q In tax reporting entities -- you have used that
15 term in your testimony; is that correct?

16 A That's correct.

17 Q If tax reporting entities are not entitled to
18 collect income tax expense in rates from customers,
19 isn't that the effect, to dictate the form of entity
20 that may operate as a regulated company?

21 A I would say, no, because the end results under
22 the S corporation and the C corporation is both
23 investors -- under the scenario that we're suggesting,
24 both investors receive the same return. And from those
25 return amounts they pay the applicable tax. There

0358

1 should be no difference between the two, as far as what
2 end investor ends up with as far as the total return.

3 Q And that takes us, I think -- I think you are
4 basing that statement on the illustration you had on
5 DPK-4?

6 A Yes.

7 Q Now, on DPK-4, which is, I believe, Exhibit
8 56 --

9 A Yes, I am there.

10 Q Under your column labeled Shareholder Level
11 related to -- there's an entry called Investment Income.
12 Do you see that?

13 A Schedule one, yes.

14 Q Well, it's actually on all schedules.

15 A Okay. Good. All schedules, yes.

16 Q And then, again, on all of those schedules,
17 there's an asterisk by that; is that correct?

18 A That's correct.

19 Q And I gather from reading that asterisk and the
20 text related to the asterisk, that you are assuming that
21 there's a 100 percent dividends payout?

22 A Yes. And I did that to simplify the problem,
23 or the illustration that you -- if you look at the
24 dynamics of return, return can either be through growth
25 of value, or through dividend payout, or actual cash

0359

1 payout.

2 So I could actually devise a more simple
3 schedule that has growth on one side, and flow-through
4 of the income on the other side, and probably prove the
5 same thing, since they are equivalent. But to keep it
6 simple, I said a 100 percent dividends payout.

7 Q And on schedules 1, 2, 3, and 4, it's a 100
8 percent pass-through of income, is your term?

9 A That's correct.

10 Q And that signifies all of the net income in an
11 S corporation is distributed to the shareholders? That
12 is what you are trying --

13 A Or is recognized by the shareholders. I will
14 avoid the word "distribute." 100 percent of the income
15 is recognized by the shareholders.

16 Q For what purpose?

17 A For income tax purposes. I am making the
18 differentiation. I hate using "distribute," because we
19 have used that to mean money actually being distributed
20 to the shareholder.

21 Q So you are not saying that the shareholder
22 actually gets 100 percent of the net income of the
23 enterprise. Is that what I understand you are saying?

24 A I am saying that the shareholder -- and I am
25 looking at schedule 2, the shareholder of the S

0360

1 corporation is not receiving \$144,000 in cash from the
2 corporation.

3 Q They are just paying the tax on that \$144,000?

4 A Yes.

5 Q Now, you have used the term -- as we talk about
6 a tax reporting entity, there are other tax reporting
7 entities besides S corporations; is that correct?

8 A That's correct.

9 Q For example, a limited liability company is
10 a tax reporting entity, as you use that term?

11 A It depends on what election they give on their
12 tax return. They could actually elect to be taxed as a
13 corporation, or they can be taxed as a partnership. And
14 if they are taxed as a partnership, then they would be
15 a tax reporting --

16 Q Would you agree that most limited liability
17 companies elect to be taxed as a partnership?

18 A Actually, I think they are. What I will say,
19 the reason the limited liability company came in
20 existence is because of the way that profits could be
21 distributed among its members.

22 A sub S corporation, for example, can only pay
23 distributions in proportion to the shareholders. If
24 they pay any other way, it's considered a different
25 level of stock, and they lose the -- an example on an

0361

1 LLC, they can keep the corporate shield, but be allowed
2 to distribute their earnings in any way they want to.

3 Q Much like a partnership?

4 A Much like a partnership.

5 Q And a partnership is characterized as a tax
6 reporting entity?

7 A Yes, it is.

8 Q Would you also agree that a wholly owned
9 subsidiary of a C corporation, where a consolidated
10 return is used, is also a tax reporting entity?

11 A No. You mean the subsidiary itself?

12 Q Correct.

13 A No. The tax law says you are separate
14 corporations. We understand you are separate
15 corporations, but we will not give you the benefit of
16 the lower tax brackets. Therefore, when you consider
17 the taxes, and the taxes are computed, we will require
18 you to consolidate them to compute your tax. But the
19 tax is allocated as part of that corporation, the
20 subsidiary. It's only because of the dynamics of losing
21 the lower levels of the tax brackets that they require
22 the consolidation to come up. That was the actual
23 reason.

24 Q But you would agree that there are instances
25 where the incremental tax rate paid by the holding

0362

1 company is lower than a particular subsidiary's
2 incremental tax rate would be if the subsidiary were on
3 a stand-alone basis?

4 A Only if the holding company had a certain level
5 of losses.

6 Q So they could have some subsidiaries that are
7 operating at a loss, and others that are operating at a
8 profit, and the two are netted out for purposes -- in
9 rough terms, the two are netted out?

10 A Yeah. It gets complicated, but, yes.

11 Q For tax payment purposes?

12 A Right.

13 Q You are not attempting to suggest that S
14 corporations are tax-free business enterprises, are you?

15 A I am not sure what he meant -- Mr. Ault meant
16 by that phrase. I am -- what I am saying is that an S
17 corporation has no tax liability, no income tax
18 liability. The shareholder has a tax liability. The S
19 corporation does not incur any tax liability. That's
20 what I am saying.

21 Q Well, I think we have some clearly delineated
22 positions here, so we will let it sit at that.

23 You would agree that an S corporation does file
24 a return with the Internal Revenue Service called the
25 1120S?

0363

1 A That's the tax report, yes.

2 Q Do you know of any closely held -- and for the
3 purposes of this discussion, let's use closely held as
4 20 or 40 shareholders.

5 Do you know any closely held C corporations
6 regulated by this Commission that distribute on a
7 regular basis dividends to their shareholders?

8 A No, I don't. One thing that is interesting
9 about the small C corporation that's very common is that
10 the shareholders are usually employees of the
11 corporation. And it's a well-known tax position, or
12 structure where the owners pull most of their earnings
13 out through salaries.

14 Q But you agree that they don't, as a regular
15 practice, pay dividends?

16 A Because of the double taxation, you are
17 correct.

18 Q And so we're consistent in the use of
19 terminology, by "double taxation," you mean that the
20 earnings may be subject -- or the dividends, if they are
21 paid, may be subject to a second round of taxes? It's
22 not meant to imply that the tax is actually double?

23 A No -- yes, that's correct.

24 Q You would agree that the Commission has, in the
25 past, approved rates for S corporations that include the

0364

1 recovery of Federal income tax in the rates paid by the
2 customers?

3 A Rephrase that so I make sure I answer it
4 correctly.

5 Q You would agree that in the past the Commission
6 has approved rates for sub S corporations that have
7 included the recovery of income tax expense in the rates
8 paid by the customers?

9 A Yes.

10 Q And you would agree that the Commission has
11 allowed limited liability companies to collect income
12 tax expense in rates paid by their customers?

13 A I have seen one that I am aware of where they
14 allow the rate to go into effect. Limited liability
15 companies are fairly new animals.

16 Q Meadows Water is a limited liability water
17 company?

18 A Yes.

19 Q And in terms of utilities, is --

20 A Yes. Now, with Meadows, in their latest
21 filing, income tax was not allowed to be recovered.

22 Q When was that case submitted?

23 A It's in my rebuttal.

24 JUDGE SCHAER: You may approach the witness,
25 Ms. Tennyson.

0365

1 MS. TENNYSON: Thank you.

2 THE WITNESS: I have a docket, it's UW-001923.

3 So it's a 2000 case.

4 Q BY MR. FINNIGAN: And was that a result of
5 operations that were agreed to by the Company in advance
6 of it being submitted to the Commission?

7 A Yes.

8 Q Just out of curiosity, are you familiar with
9 the corporate structure for Alderbrook Water Company?

10 A No, I am not.

11 Q The 1998 annual report for Alderbrook indicates
12 that it is owned by Christian Ministries. Did you have
13 occasion to look at that?

14 A Mr. Ward did. I didn't.

15 Q Religious organizations normally are not tax
16 paying entities?

17 A If they have a business, they are. They pay
18 tax on the business, because the church itself, or the
19 religious organization, that's exempt.

20 Q Would you accept, subject to check, that in the
21 1998 Report, Account No. 409, Federal Income Tax Expense
22 for Alderbrook is blank for both the current year and
23 previous years' entries?

24 A Yes, I would accept that. I would make a note
25 that I know they were also involved in a hotel, and some

0366

1 other stuff. It might have been that they had some NOL,
2 or operating losses from the other that affected --
3 but that -- but that's just an observation.

4 Q But you would agree that in 1999 -- for the
5 calendar year, for the test year ending September 1998,
6 they were allowed a Federal income tax expense?

7 A Is that part of Ms. Parker's exhibit?

8 Q I believe it is. I can't represent that at
9 this moment. The docket number, for your information,
10 is UW-590970.

11 A She has it on her list, and it shows a tax
12 figure being a proforma tax figure, Federal tax per
13 book, Zero. So you are correct.

14 Q And I take it you did review that exhibit
15 submitted by Ms. Parker, and verified her numbers were
16 accurate?

17 A I didn't go through all of them. I looked at
18 the S corporations that she showed.

19 Q So you looked at it, and you agreed that the
20 numbers she represents are accurate?

21 A Yes.

22 Q For the ones you looked at?

23 A For the ones I looked at.

24 Q Would you please look at exhibit -- and we will
25 try to go through these in fairly rapid succession --

0367

1 Exhibits 70, 71, 72 and 73?

2 A I have them.

3 Q Would you agree that for the 1996 rate case,
4 Rainier View was authorized, as part of its operating
5 and maintenance expenses, to include Federal income tax
6 recovery? If you look at the third page of the exhibit,
7 line 34 --

8 MS. TENNYSON: I am looking at Exhibit 70?

9 MR. FINNIGAN: I am sorry. Yes.

10 THE WITNESS: Yes. And I notice with this one,
11 too, that interest expense was not deducted before they
12 calculated the Federal income tax. But, yes, you are
13 right.

14 Q BY MR. FINNIGAN: And moving to Exhibit 71, and
15 then again, it happens to be the third page of the
16 exhibit, the results of operations as approved by the
17 Commission include recovery of Federal income tax
18 expense?

19 MS. TENNYSON: I am sorry. Did you use the
20 term "approved by the Commission"?

21 MR. FINNIGAN: Yes.

22 THE WITNESS: (Reading document.) Yes, it's
23 there. And, again, it appears that interest hasn't been
24 deducted. But, yes, it's there.

25 Q And going now to Exhibit 72 -- and for the life

0368

1 of me I can't figure out why there are two of them two
2 weeks apart. But I don't think the changes are material
3 for our purposes.

4 If you would go to the third page of Exhibit
5 72, line 31, would you agree the Commission allowed the
6 recovery of Federal income tax expense for that filing?

7 A Yes.

8 Q And if you will turn to the last two pages of
9 that exhibit -- do you have that?

10 A Yes, I do.

11 Q And that is a Commission order; is that
12 correct?

13 A Yes, it is.

14 Q And that's the Commission order that approved
15 the filing in this 1993 rate case?

16 A Yes.

17 Q Would you look under the findings, please.

18 A Yes.

19 Q And would you read that portion aloud?

20 A "After careful examination of the tariff filed
21 herein by Rainier View Water Company, Inc., March 12,
22 1993, and giving consideration of all relative matters
23 and for good cause shown, the Commission finds that the
24 tariff revisions should become effective March 25th,
25 1993."

0369

1 Q Thank you. Going to Exhibit 73, please, would
2 you agree on page 1 of this exhibit the Company was --
3 Rainier View was allowed to recover income tax expense
4 in its rates?

5 A Yes.

6 Q Going to the last two pages, would you identify
7 the last two pages of the exhibit, please?

8 A Again, appears to be an order of the Commission
9 related to this filing, 920295.

10 Q And the Commission makes a similar finding in
11 this case as it did in the 1993 case?

12 A Yes.

13 MR. FINNIGAN: I will offer Exhibits 70 through
14 73.

15 MS. TENNYSON: No objection.

16 JUDGE SCHAER: Those documents are admitted.

17 (EXHIBITS ADMITTED)

18 Q BY MR. FINNIGAN: In light of the hour,
19 Mr. Kermode, I am going to substantially shorten our
20 trip through Exhibit 14, DF-14. You are familiar with
21 that exhibit, aren't you?

22 A Yes.

23 Q And you would agree with me that there is
24 Federal income tax recovery contained in many of these
25 contracts?

0370

1 A Related solely to contributions in and of
2 construction, yes.

3 Q And you would agree for some of these contracts
4 there are Commission orders that specifically approve
5 those contracts?

6 A Yes.

7 MR. FINNIGAN: I will leave it at that, instead
8 of a year by year trip.

9 JUDGE SCHAER: You mean we're not going through
10 1200 pages page by page?

11 MR. FINNIGAN: In hopes of finishing tonight,
12 we will accept the summary of that.

13 Q BY MR. FINNIGAN: Now, you draw distinction in
14 your testimony between income tax recovery from general
15 rates, and income tax recovery from contributions in aid
16 of construction; is that correct?

17 A That's correct.

18 Q And the Internal Revenue Service views both as
19 income; isn't that correct?

20 A That's correct.

21 MR. FINNIGAN: I think I will stop there.

22 JUDGE SCHAER: Thank you. I do have some
23 questions, Mr. Kermode.

24

25

EXAMINATION

0371

1

2 BY JUDGE SCHAER:

3 Q Do you have copies of Exhibit 1 and 2 with you?

4 A That's my exhibits, correct?

5 Q No. That's the portions of the Bench Request
6 responses.

7 A Related --

8 Q I would like you to have both the one related
9 to you, and the one related to the Company.

10 A I believe I do.

11 Q Why don't you take a moment and find those,
12 because I am going to be asking you about those and
13 about some things in your prefiled testimony. And it
14 might be nice for you to have them available. And while
15 you are doing that --

16 JUDGE SCHAER: I want to take a moment and
17 introduce our newest judge who is back from Mexico, and
18 relaxed.

19 This is Judge Theo Mace.

20 JUDGE MACE: I think I have actually met some
21 of the people in the room, but to the extent I haven't,
22 thanks for the introduction.

23 JUDGE SCHAER: We want to welcome you.

24 THE WITNESS: I have a copy of the Staff
25 Response to Daily Request -- Response to Data Request,

0372

1 and the Company's.

2 Q BY JUDGE SCHAER: That should be sufficient,
3 yes. Exhibits 1 and 2 will get us there, but that is
4 what they are.

5 I would like you first to look at Exhibit 2,
6 which is Staff's response to the Bench Requests. And
7 look at the response to Bench Request No. 1, please.

8 A I have them.

9 Q In essence, I take it what you are saying is
10 that on the end of period rate base, you would recommend
11 an overall return of 8.56 percent, and on average rate
12 base you would recommend a return of 8.69 percent?

13 A That's correct.

14 Q And you are proposing the use of an average
15 rate base, correct?

16 A Yes, I am.

17 Q And that average rate base is based on the
18 beginning and end of your -- of test year balances,
19 correct?

20 A Yes, ma'am.

21 Q What would your capital structure and cost
22 rates of debt and equity be using an average capital
23 structure?

24 A (Looking at document.)

25 MR. FINNIGAN: For my clarification, do you

0373

1 mean 50/50?

2 JUDGE SCHAER: By average, I mean the average
3 between the beginning of the year, and end of the year
4 amounts, Mr. Finnigan.

5 MR. FINNIGAN: Okay.

6 THE WITNESS: I have it on my computer. I
7 didn't bring it with me.

8 Q BY JUDGE SCHAER: When you went from end of
9 year capital structure to average capital structure, do
10 you recall if you changed the ratios of equity and debt,
11 or if you changed any of the cost levels?

12 A No, I took the cost.

13 Q And I am comparing here to the numbers that you
14 have for the end of the year, so that's clear.

15 A Yes, ma'am.

16 Q Go ahead.

17 A What I did was I took the weighted debt, came
18 over directly then to produce the proper coverage ratio.
19 The equity amount had to increase. The weighted cost of
20 equity had to increase. And then the weighted amount
21 fell out to be 8.69. So the weighted cost of debt
22 remained the same.

23 Q So the change from 8.56 to 8.69 is entirely
24 based an increase in cost of the equity. Is that what
25 you are saying?

0374

1 A Yes, ma'am.

2 Q And would you accept, subject to check, that
3 the equity rate that you used to come up with this
4 overall return was 16.29 percent?

5 A Subject to check, that sounds reasonable. Yes.

6 Q I would like you to look, again, at Exhibit 2,
7 and look at the Staff's response to Bench Request
8 No. 7.

9 A Yes, ma'am.

10 Q I take it from this response that you did make
11 an adjustment to interest expense to synchronize
12 interest expense to your capital structure and rate of
13 return recommendations; is that correct?

14 A It was my understanding that I did that, yes.

15 Q That is still your understanding?

16 A Yes, it is.

17 Q Now, staying with Exhibit 2 and your responses
18 in answer to Bench Request No. 8, the net to gross
19 conversion factor calculation, you indicate in the
20 footnote that the utility B&O tax adjusted for bad debt
21 is .0065. So the utility B&O tax factor before your
22 adjustment would be 0.05029, or 5.029 percent; is that
23 correct?

24 A That's correct.

25 Q In addition to your adjustment to B&O taxes,

0375

1 for the uncollectible factor, you again include the
2 uncollectible factor of 0.0065 in your conversion factor
3 calculation; is that correct?

4 A That's correct.

5 Q What is the basis of your uncollectible factor
6 of 0.0065?

7 A That was based on my analysis that I did
8 related to actual write-offs of the Company, and my
9 analysis of the ending accounts receivable. So the
10 .0065 is the amount that I recognize in the results of
11 operation as a percentage of gross revenue.

12 Q And how did you calculate that factor?

13 A Again, I analyzed the aged accounts receivable,
14 and also did an average of the write-offs over, I
15 believe, five years, came up with a figure.

16 Q I want to turn, now, to your testimony, Exhibit
17 T-53 at page 16, lines 16 through 20.

18 A Page 16?

19 Q Page 16, yes.

20 A I am sorry. What lines?

21 Q 16 through 20, please.

22 A Yes.

23 Q In your testimony you indicate that with an S
24 corporation, like Rainier View, stockholders, rather
25 than the company, pay the Federal income tax associated

0376

1 with the earnings generated by the Company, correct?

2 A Yes.

3 Q In your view, if the Company does not
4 distribute any earnings to the stockholders, the
5 Richardsons, who are the stockholders of this company,
6 should pay the income tax liability on the Company's
7 earnings out of their own pocket, then; is that correct?

8 A As I see it, the Company has earnings of, let's
9 say, hypothetically, \$100,000. If they do not
10 distribute money from the corporation to pay for that
11 income tax, then they would have to take it out of
12 savings, but their net wealth still remains the same.

13 If, hypothetically, they had to pay \$30,000
14 income tax, if you combined the total amount of their
15 wealth under both scenarios, you have a scenario where
16 they pay for it out of their savings or pay for it out
17 of the corporation, their net wealth will remain the
18 same. There's no difference.

19 Q Are you advocating that the Company should not
20 distribute any amount to the Richardsons to pay the
21 taxes on Company generated earnings?

22 A Oh, my gosh, no. I think that's part of being
23 an S corporation, or partnership, or anything like that.

24 Q As was discussed under the cross examination of
25 Ms. Ingram -- I believe you were here for her this

0377

1 morning?

2 A Yes, ma'am.

3 Q Are you advocating that it would be perfectly
4 acceptable for the IRS to confiscate the home of an
5 owner/operator of a regulated utility, if the
6 stockholder cannot pay out of pocket the Federal taxes
7 generated by the regulated utility?

8 A No, ma'am.

9 Q Are you advocating that since the stockholders
10 have to pay all of the income taxes associated with
11 company generated earnings, that the stockholders should
12 take all earnings out of the Company for their own
13 private use, rather than leaving any money in the
14 Company?

15 A No. I am saying that the Company -- this is
16 net earnings. They have made money. The net earnings,
17 it's up to them if they want to distribute the tax
18 portion, or the entire amount. It's totally -- they can
19 make that decision. But I am not advocating that they
20 not be allowed to, nor am I advocating that they should
21 be forced to take it all out.

22 Q If, in a hypothetical, they were to take all of
23 the equity capital out, that would leave the Company 100
24 percent debt financed, and indeed, under those
25 circumstances, there would be no income taxes; is that

0378

1 correct?

2 A The owners would no longer incur a tax
3 liability, because they would be -- to keep the theory
4 simple, yes, they would have no tax liability if it was
5 100 percent debt, and they made no income.

6 Q I would like you to assume that the Richardsons
7 withdrew all of their equity out of the Company so that
8 the Company was 100 percent debt financed. And assume
9 that the rate making process was perfect, and the
10 Company received rates that exactly covered operating
11 expenses and interest expense. And assume there are no
12 book versus tax timing differences. And assume further
13 that all operating expenses and interest expenses are
14 deductible for Federal income tax purposes.

15 Under those assumptions, neither the Company
16 nor the shareholder would have to pay any income taxes;
17 is that true?

18 A That's true.

19 Q Thank you. Now, in your working capital
20 calculations you include contributions in aid of
21 construction as vested capital; is that correct?

22 A (Looking at documents.)

23 Q You may want to refer to your Response to Bench
24 Request No. 6.

25 A Oh, I am sorry. Yes, total investor capital,

0379

1 yes.

2 Q The Company incurred certain cost of financing,
3 or has certain debt discounts or premiums. Would that
4 change any of the net proceeds that would be made
5 available to the Company in a long-term net loan?

6 A I am sorry. Say that again?

7 Q If the Company incurred certain costs of
8 financing, or has certain debt discounts or premiums,
9 would those factors change the amount of net proceeds
10 that would be made available to the Company if it took
11 out a long-term debt loan?

12 A Normally, yes.

13 Q Looking, now, at Exhibit T-53, at page 28,
14 lines 22 to 30.

15 A (Looking at document.) Yes.

16 Q This is a discussion of reduction of Indian
17 Springs rates to obtain parity with the rest of Rainier
18 View's rates?

19 A Yes.

20 Q And you argue that that change is not
21 measurable; is that correct?

22 A I am saying that it's part of the filed tariff
23 and it should be recognized as an adjustment to proposed
24 rates, not as a proforma adjustment.

25 Q Okay. Well, has that happened yet?

0380

1 A No. It's part of the rate filing.

2 Q So that's my second question. Is the Indian
3 Spring tariff suspended in this filing?

4 A Indian Spring?

5 Q Indian Spring.

6 A Yes, it is.

7 Q So if the Commission were to lower those rates
8 in this proceeding, it would be appropriate to take that
9 into account, but not in the manner proposed by the
10 Company? Is that what you are saying?

11 A That's right. Yes.

12 Q Just one more point I would like to get from
13 you. In the private sector would an S corporation price
14 its product not to recover any Federal income taxes
15 incurred by either the Company or its stockholders?

16 A Normally in the private market you have
17 competition. So they would set their rates, or set
18 their price based on what the market is. I actually
19 thought about that, and considered that. So if they are
20 in a market or in an industry where there's a high
21 return, then they would set their -- the price of their
22 product would produce a high return. If they have low
23 return, the price -- if it was a low-return industry,
24 then the return you would receive is low. They would
25 have to compete.

0381

1 JUDGE SCHAER: Those are the questions I had.

2 Did you have any questions brought on by those,
3 Mr. Finnigan, before we have redirect?

4 MR. FINNIGAN: Yes. I would like to follow up
5 on the last hypothetical, if I could, please.

6 JUDGE SCHAER: Go ahead, please.

7

8 RE CROSS EXAMINATION

9

10 BY MR. FINNIGAN:

11 Q If there's a return high or low, as long as
12 there's a positive return, there's an income tax
13 associated with that; is that correct?

14 A Yes.

15 Q So the answer to the hypothetical that was
16 posed is that the effect, the income tax effect felt by
17 the Company would be considered in the prices that are
18 set by the Company?

19 A I would say that the price that is being set by
20 the Company is being driven by competition, and not
21 normally by analysis of what the expenses are.

22 Q Isn't it in fact the case that Congress many
23 times uses tax policy to encourage investment in
24 particular industries?

25 A Yes.

0382

1 Q So isn't it correct that the effect of income
2 tax laws is a consideration in the decisions to invest
3 and the prices set from the products from the
4 investment?

5 A In the industry, yes.

6 JUDGE SCHAER: Do you have any redirect?

7 MS. TENNYSON: Yes, I do. And I would like to
8 offer Exhibit 56.

9 MR. FINNIGAN: I have no objection to that
10 exhibit. As long as we're on that, I do note that I
11 have neglected to offer 65. And I would do that.
12 That's the response to Data Request.

13 MS. TENNYSON: I have no objection.

14 JUDGE SCHAER: 56 has been offered, and I will
15 admit that now.

16 (EXHIBIT ADMITTED)

17 JUDGE SCHAER: What was the number,
18 Mr. Finnigan?

19 MR. FINNIGAN: 65. We're doing a mirror image.

20 JUDGE SCHAER: 65, do you have any objections?

21 MS. TENNYSON: No, I do not.

22 JUDGE SCHAER: That document is admitted.

23 (EXHIBIT ADMITTED)

24 JUDGE SCHAER: So at this point, we have 44 and
25 49 and 40 that were withdrawn. We have 28 that has not

0383

1 been dealt with.

2 MS. TENNYSON: I thought that was duplicated by
3 another exhibit.

4 JUDGE SCHAER: That's fine. I just wanted to
5 make sure if anyone was thinking those were in, they
6 wouldn't have a nasty surprise.

7 MS. TENNYSON: Let me double check that.

8 JUDGE SCHAER: Go ahead, Ms. Tennyson.

9 MS. TENNYSON: I thought Exhibit 28 was
10 duplicated by an offer -- by an exhibit offered by
11 Mr. Finnigan.

12 JUDGE SCHAER: That's fine.

13 MS. TENNYSON: I do appreciate that. I don't
14 believe it was. I may be mistaken in that.

15

16

17

18 REDIRECT EXAMINATION

19

20 BY MS. TENNYSON:

21 Q Mr. Kermode, do you have a copy of Exhibit 28?

22 A Could you describe it?

23 Q RA-4, the Richardson Salary Adjustment.

24 A Yes, I do.

25 Q And is this your workpaper related to how you

0384

1 calculated your adjustment for -- it's included in your
2 results of operations for Mr. Richardson?

3 A Yes.

4 Q I think.

5 MS. TENNYSON: I think it might help the record
6 if we had it included in it. I would offer this
7 exhibit.

8 JUDGE SCHAER: Any objection.

9 MR. FINNIGAN: No. I think there were
10 questions about it earlier, but it was never offered. I
11 don't have no objection.

12 JUDGE SCHAER: Exhibit 28 is admitted.

13 (EXHIBIT ADMITTED)

14 Q BY MS. TENNYSON: And referring to Exhibit 44,
15 the Company's Response to Staff's Data Request No. 36,
16 do you have that?

17 A Yes, I do.

18 Q Is this a response that Staff received in
19 response to data requests from the Company?

20 A Yes.

21 Q Can you describe the topic of this for us?

22 A It's the depreciation related to Indian
23 Springs, the Indian Springs acquisition. I had
24 included, which I don't have copies of -- I had included
25 a sheet related -- or copies of the depreciation detail

0385

1 schedule.

2 MR. FINNIGAN: Your Honor, I am going to
3 object. This is not a subject I even talked about in my
4 cross examination, so I object on the basis it exceeds
5 the scope of cross.

6 JUDGE SCHAER: Ms. Tennyson?

7 I am not sure she offered it yet.

8 MR. FINNIGAN: Well, I am sure she was headed
9 in that direction, and the line of questioning.

10 JUDGE SCHAER: If you want to let her get
11 there, that that might be a better way to proceed to see
12 if there's any more foundation that she wants to deal
13 with.

14 MR. FINNIGAN: The witness was starting to
15 testify about the exhibit itself. That's why I felt I
16 should object at this point.

17 MS. TENNYSON: I believe he was identifying the
18 documents. There was Attachment A and B to the request.

19 MR. FINNIGAN: If all he was doing is
20 identifying, we can let him identify.

21 MS. TENNYSON: That's where we were heading.

22 JUDGE SCHAER: That was the question, was to
23 describe what was in this document?

24 MS. TENNYSON: Yes.

25 THE WITNESS: Yeah, Attachment A --

0386

1 JUDGE SCHAER: Attachment A and Attachment B
2 were -- and I would like a quick answer on that.

3 THE WITNESS: Attachment A is two copies of the
4 depreciation detail related to the Indian Springs
5 acquisition. Attachment B is a summary of what shows on
6 the detailed depreciation schedule, and what the
7 depreciation expense is.

8 JUDGE SCHAER: Thank you.

9 Q BY MS. TENNYSON: And you were present when
10 Mr. Ault testified about the catch-up adjustment?

11 A Yes, I was.

12 Q And you were -- do you recall what he was
13 advocating about the catch-up adjustment, or the
14 difference?

15 A He was saying --

16 MR. FINNIGAN: Well, I think -- I guess I will
17 renew my objection at this time, because we are going
18 well beyond the scope of my cross examination now,
19 talking about essentially surrebuttal, I guess.

20 JUDGE SCHAER: Well, I thought -- go ahead.

21 MS. TENNYSON: Well, Mr. Ault testified quite a
22 bit about this matter, but declined to identify the
23 document because he was not the one responding to the
24 request. He was the one that testified about
25 depreciation, therefore, which is the reason I didn't

0387

1 ask Mr. Fisher about this, because Mr. Fisher didn't
2 testify about the depreciation adjustment.

3 It was Mr. Ault's testimony, but Mr. Ault was
4 unable to identify the documents. I think Staff can
5 easily identify a response to a data request that was
6 propounded. And merely because this witness wasn't
7 asked on cross examination about his depreciation
8 adjustments, I don't think is a reason to disallow the
9 exhibit when the Company's witnesses did testify on
10 these same matters.

11 JUDGE SCHAER: So you are asking the question
12 as foundation?

13 MS. TENNYSON: Well, the question in this case,
14 the testimony that was presented was -- to which this
15 data request relates was presented only on the rebuttal
16 testimony of the Company. Therefore, Mr. Kermode did
17 not have an opportunity prior to, you know, receiving
18 the response to this data request to even address any of
19 the issues. And we were simply looking to have the
20 Company's explanation in response to that admitted as an
21 exhibit.

22 MR. FINNIGAN: If all you want is the exhibit
23 in, I am not going to have a problem with that.

24 MS. TENNYSON: That's all I am asking.

25 JUDGE SCHAER: Well, you had talked about

0388

1 objecting, so I asked for more foundation. So I think
2 we're at that point.

3 You are not going to object, so go ahead and
4 offer it.

5 MR. FINNIGAN: If that's all we're doing, let's
6 go through with it. But I don't have any objection to
7 the documents.

8 MS. TENNYSON: I would offer Exhibit 44.

9 MR. FINNIGAN: No objection.

10 JUDGE SCHAER: The document is admitted.

11 (EXHIBIT ADMITTED)

12 MS. TENNYSON: Just to clarify, I assume
13 Ms. Parker's testimony and exhibits were admitted? I
14 don't have them marked as such on my schedule.

15 JUDGE SCHAER: Yes, they were. The only two
16 items that have been passed over are now Exhibits 40 and
17 49. I'm not asking you to do anything --

18 MS. TENNYSON: I do not intend to offer those.

19 JUDGE SCHAER: Go ahead with your redirect,
20 please.

21 MS. TENNYSON: Thank you.

22 Q BY MS. TENNYSON: Mr. Kermode, you were asked
23 some questions by Mr. Finnigan related to Exhibit 63,
24 his simplistic view of a water company. Do you recall
25 those?

0389

1 A Yes, ma'am.

2 Q And one of the questions asked was if there
3 were, say, five developments on the diagram, but only
4 three were built, would that -- there would still be a
5 need for plant related to that to be included within the
6 water company. At some point would there be a concern
7 about cost being included, and what would be the concern
8 that you might have?

9 A There's a question of used and useful. So,
10 yes, the Company would need the plant there, there's no
11 question. You wouldn't take out plant. But for rate
12 making purposes, if it was built for five large
13 developments, and only three of the large developments
14 were being developed, then the possibility -- and the
15 rate review would be the two-thirds of the system would
16 be put into a for-future-use type basis, or it would
17 be -- would not be allowed to be put in rates under a
18 used and useful type question.

19 And once the other two developments got going,
20 then those costs would flow through to the appropriate
21 rate payers.

22 Q You were asked if you visited the Rainier View
23 facility, and you said, yes, you had, two times, I
24 believe?

25 A Yes, ma'am.

0390

1 Q Could you estimate how many hours you spent at
2 the Company's offices?

3 A Five, six hours.

4 Q Is that one time, or two times?

5 A Two times each, time -- 12 hours.

6 Q During that time did you have any contact with
7 Mr. Richardson?

8 A No, I never met him or talked to him.

9 Q You were asked questions about revenue
10 sensitive adjustments that you had referred to in your
11 testimony. And Mr. Finnigan asked you if B&O tax was
12 one, and/or you may have replied that would -- the
13 Utilities and Transportation Commission's regulatory fee
14 also would be a revenue sensitive adjustment?

15 A Yes. That also increases or decreases
16 depending on the revenue.

17 Q Mr. Finnigan asked you about functions or
18 services that could be performed without being a water
19 company, such as testing of water and pressure. And I
20 think, as you summarized by saying, there's a whole
21 category of functions that could be provided by SMAs
22 that are not regulated water companies, correct?

23 A Correct.

24 Q How are -- how do SMAs operate? What do they
25 do?

0391

1 A They normally contract with the water company
2 to do certain functions; test the water, for example.

3 Q And would the costs of those contracts be
4 recovered in rates?

5 A They would be included in the operating
6 expenses.

7 Q So they would show up on the Company's income
8 statement?

9 A Yes, they would.

10 Q And regulated customers, would they pay for
11 those?

12 A Yes.

13 Q You were asked a question about how the rates
14 of Rainier View Water Company compared. On the range of
15 regulated water companies that you are familiar with, in
16 making recommendations to the Commission on water rates,
17 does Staff consider what other water companies charge?

18 A No, because each water company has its own
19 structures and dynamics. So, no, we don't look at and
20 consider other rates around in the area.

21 Q As the size of the company grows, are there
22 some benefits to customers, or changes?

23 A There should be. As the company grows, overall
24 fixed costs per customer should drop.

25 Q So in terms of -- do you know where Rainier

0392

1 View Water ranks among the WUTC regulated -- where in
2 terms of customers, whether the high or low end?

3 A I think they are the second largest.

4 Q You were asked some questions about the Chevy
5 C35, and how you dealt with your recommendation on what
6 kind of -- what costs should be allowed for a vehicle
7 driven by Mr. Richardson.

8 Do you care what vehicle the Company purchases?

9 A No. Matter of fact, the Navigator they have,
10 they obviously -- it's in the Company. And I haven't
11 recommended that they sell it or anything. What I am
12 concerned about, and I mentioned it before, is that a
13 certain level of comfort should be allocated where the
14 rate payer bears that cost. So I am recommending a
15 level that I think is reasonable for the rate payer to
16 pay. The Company can have any type of vehicle it wants,
17 but the rate payer should only shoulder a certain level
18 of cost related to that.

19 Q You were asked some questions relating to legal
20 or litigation expenses being included in a couple of
21 cases that Mr. Finnigan referred you to.

22 Do you know if those cases were resolved at the
23 Staff level and presented to the Commission in an open
24 meeting, or whether they were litigated?

25 A I believe they were resolved and presented.

0393

1 Q And was that expense, the legal expense spread
2 over a period of time, if you know?

3 A I looked at the North Bainbridge, and that was
4 a five-year amortization.

5 Q You were asked questions relating to the
6 calculation of debt, and whether debt was at a
7 historical high, and how the Commission might treat
8 that.

9 How do you look at debt when you are looking at
10 the level of debt to be set when the Company files a
11 rate case?

12 A I try to get as close to when rates will go
13 into effect. So whatever the test year had, or five
14 years prior, it doesn't matter. I try to look at the
15 current costs involved that goes along with equity, and
16 I try to put in place as close as possible --

17 Q So if the Company used a test year, and that's
18 12 months before the time you are looking at, or 15
19 months, you say you wouldn't look at that cost of debt
20 at the beginning of that period?

21 A No. I am concerned that the Company has the
22 money to pay its interest costs. So hypothetically, if
23 the rates were one point lower during the test year, and
24 they went up a point during the regulatory process, I
25 would add that point to the interest and increase

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1 expenses by that point.

2 Q Do you know if that is the Commission's
3 practice, generally?

4 A Yes, it is.

5 Q And is predicting interest rates an exact
6 science?

7 A No, it's not.

8 Q Is predicting the costs a company will incur in
9 the next year an exact science?

10 A No.

11 Q Do we -- well, I guess I don't need to pursue
12 that.

13 You were asked a question about a hypothetical
14 capital structure and balancing safety. Can you tell us
15 generally when the Commission uses a hypothetical
16 capital structure?

17 A Usually the issue revolves around an equity
18 rich capital structure, because of the cost. It's an
19 expensive capital structure. So by reducing it -- or I
20 am sorry, by using a hypothetical capital structure
21 equity is reduced to, let's say, a 50 percent level,
22 reducing the overall cost.

23 So now the hypothetical capital structure has
24 solved that. We have actually realized a lower cost
25 capital structure.

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1 On the other hand, if a company is highly
2 leveraged, very rich in debt, now we have a question as
3 far as safety goes, the ability to service that debt. A
4 hypothetical capital structure doesn't solve that other
5 than giving more return to the equity owner.

6 If I am going to have to -- like in this case,
7 if I am going to give a higher return because of debt
8 service problems, I want to be explicit. I will do it,
9 like in this case, in a ratio with same rates on a debt
10 service ratio basis, not using a hypothetical capital
11 structure. Hypothetical capital structure doesn't
12 really solve the problem.

13 JUDGE SCHAER: Let's go off the record for a
14 moment.

15 (Discussion off the record.)

16 JUDGE SCHAER: Let's be back on the record
17 after a brief recess.

18 Go ahead, Ms. Tennyson.

19 MS. TENNYSON: Thank you.

20 Q BY MS. TENNYSON: When you were asked a series
21 of questions relating to the steps that Mr. Fisher
22 described the Company going through to obtain a piece of
23 property that a developer -- part of a system that a
24 developer is building, Mr. Finnigan walked you through
25 the steps of the roads going in, and that sort of thing.

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1 Now, is the Company incurring costs during that
2 time?

3 A Once they get to the point where they are
4 actually charging the system and preparing it, testing
5 the water, heating the system, they are incurring costs,
6 yes.

7 Q And what about meetings that might happen
8 before that?

9 A On the transfer, sure, negotiating the
10 contracts for transfer.

11 Q System design?

12 A Legal costs -- system design is usually with
13 the developer, I think. There's probably an interface
14 as far as what the Company's standards are, so they
15 would have to work with the Company. But I think the
16 developer carries the main part of the design.

17 Q Where are the costs of those activities on the
18 part of the water company recovered?

19 A Through the income statement, through rates.

20 Q So regulated customers, the customers of the
21 water company, are paying for those?

22 A Yes. Either they are capitalized, or they will
23 flow through directly. But, yes, one way or the other
24 the rate payer will pay it.

25 Q You were asked a question relating to whether

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1 the results of operations for the Meadows Water Company
2 with the latest filing where income taxes were not
3 allowed to be recovered -- whether that was an agreed
4 matter. If a matter is going to the open meeting and
5 not contested, wouldn't the results of operations be
6 agreed in all of those cases?

7 A Yes.

8 Q You were asked a question by Ms. Schaer about
9 whether you advocated -- or would advocate that the IRS
10 seize the owner's home if the owner didn't pay the tax
11 on the regulated income. And I believe that you
12 answered that you were not advocating that.

13 I guess I am a bit confused, because I am not
14 sure that's consistent with your earlier testimony.

15 A Well, I would say that, quite frankly, I guess
16 I would not advocate or be against it. It's a process
17 that the IRS does. When somebody doesn't pay their
18 taxes and they owe money, the IRS will go after whatever
19 assets that the tax payer has.

20 Q So you are not saying you are advocating this
21 method?

22 A I am not supporting, nor am I against it. It's
23 one of those realities of life. If a person fails to
24 pay their taxes, they have income, they have liability,
25 and they fail to pay it, the IRS will start the long

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1 process of liens, and negotiations, and I guess finally,
2 if they don't get anything, then seizure. But that's
3 between the IRS and the tax payer; not me.

4 Q So if the owner of a water company that is not
5 a C corporation has net earnings, and chooses not to pay
6 the taxes, you are not advocating the Company be liable
7 for those taxes, are you?

8 A No. No. The Company is a corporation and it's
9 an asset of the tax payer, and it's up to the IRS to
10 make its decision without, I think, without any regard
11 as to if it's an S corp or C corp. It's an asset, and
12 he -- the IRS wants their money.

13 Q You were also asked some questions by the Judge
14 about average rate base, and average capital structure.
15 Are those different concepts? I was getting somewhat
16 confused in your responses.

17 A They should be synchronized. They should be --
18 they are one and the same animal. You have the average
19 rate base, and you will have -- usually reflecting that
20 average rate base should be what capitalizes it, which
21 is the capital structure.

22 MS. TENNYSON: I have nothing further at this
23 time.

24 JUDGE SCHAER: Anything else for this witness?

25 MR. FINNIGAN: Just a few questions.

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1 JUDGE SCHAER: Go ahead, Mr. Finnigan.

2

3 RECROSS EXAMINATION

4

5 BY MR. FINNIGAN:

6 Q You were asked, Mr. Kermode, about the
7 developer line extensions, and the meetings, and
8 negotiating the contract and that by Ms. Tennyson. Do
9 you know how Rainier View treats those costs?

10 A Like I said, either they would have to be
11 capitalized, or they would flow through.

12 Q Do you know how they treat those costs?

13 A I have seen no document that explicitly
14 addresses that, no.

15 Q If they were capitalized, you would agree that
16 they would be associated with the plant, and would be
17 subject to end of year, beginning of year averaging when
18 that plant went in service?

19 A If it was a test year, yes.

20 Q You had some questions related to a
21 hypothetical capital structure, and I believe what I
22 heard you say -- and maybe I am wrong -- is that
23 hypothetical capital structures have not been used for
24 highly leveraged companies?

25 A No. I don't think I said that. I gave you my

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1 opinion as to what I --

2 Q You would agree that the Commission has, in
3 fact, used hypothetical capital structures for highly
4 leveraged companies?

5 A Yes. I think I have seen cases involved, yes.

6 Q So that is a methodology the Commission deems
7 acceptable?

8 A Yes. What I am suggesting is a debt service
9 coverage ratio is a more direct solution to a high
10 leverage problem in a hypothetical.

11 Q But you are not trying to suggest that the
12 Commission has never used that?

13 A Oh, my, no.

14 Q You were asked about legal fees, and you
15 answered by giving an example of the North Bainbridge
16 amortization?

17 A Yes.

18 Q You are aware that that was quite a large bill,
19 in the neighborhood of \$100,000 in legal fees?

20 A 84 comes to mind. But you are probably right.
21 I was looking at a document, and it might have been a
22 pre-updated document.

23 Q And you are also aware that for other companies
24 a three-year amortization has been used when there has
25 been a lesser dollar amount involved?

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1 A I have seen a three-year, yes.

2 Q You were asked a question about when you were
3 visiting the Rainier View facility about not meeting
4 Mr. Richardson?

5 A Yes.

6 Q Did you ever ask to meet Mr. Richardson?

7 A No, I did not.

8 Q And then the last question you were asked, sort
9 of our illustrations about a water system plant, you
10 would agree with me, wouldn't you, that it's awfully
11 difficult to flow water through three-fifths of a
12 distribution main?

13 A Oh, yes.

14 MR. FINNIGAN: Thank you. Those are all the
15 questions I have.

16 JUDGE SCHAER: Any more questions,
17 Ms. Tennyson?

18 MS. TENNYSON: No, I do not.

19 JUDGE SCHAER: Mr. Kermode, thank you for your
20 testimony. I think at this point --

21 MS. TENNYSON: That concludes the Staff's
22 presentation in this case.

23 JUDGE SCHAER: Excuse me. At this point I
24 would like to talk about next steps according to our
25 schedule for the case. I was supposed to get a brief

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1 outline of issues today at the end of the hearing, but
2 somehow --

3 MS. TENNYSON: Mr. Finnigan and I are both
4 blushing --

5 JUDGE SCHAER: Somehow I don't think you will
6 get that done in 20 minutes.

7 We have a Bench Request that's due by February
8 28. And I am wondering if that's a reasonable time to
9 have the outline of issues also provided?

10 MS. TENNYSON: Yes. I think we can do it
11 sooner.

12 MR. FINNIGAN: We can.

13 JUDGE SCHAER: I want you to be sure you come
14 up with an outline that both of you will follow. I want
15 you to be sure you use the same number for the same
16 adjustments so that when we look at the briefs, we can
17 tell where there's controversy.

18 And then the next thing we should talk about
19 briefly is, I am looking at our procedural rules, at WAC
20 480.97.36. There have been some items that have been
21 asked subject to check, and that is the rule that we
22 have regarding subject to check.

23 According to this rule, you have 10 days after
24 receipt of the transcript to either send in a letter
25 saying you do not accept something subject to check, or

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1 to let this time go by and have that information be
2 included in the record.

3 I am noting that two weeks from today is the
4 28th of February. And I believe with our counting rules
5 with the court reporter, that would mean that March 1 is
6 the day that we can expect to receive transcripts. And
7 since your briefs are due on March 12, I thought you
8 might want to consider shortening that time in some way
9 so you would be able to have that information resolved
10 before you finish writing your briefs.

11 That doesn't necessarily have to happen here if
12 you want to deal with it informally. But I do want to
13 at least caution that that may be a concern.

14 I am expecting with your briefs to receive
15 proposed findings and conclusions.

16 Is there anything else we need to talk about
17 today?

18 MS. TENNYSON: I don't believe so.

19 JUDGE SCHAER: Mr. Finnigan, any concerns, or
20 anything else we need to talk about today?

21 MR. FINNIGAN: No. I have a thought that's in
22 the back of my mind, but it's something I will approach
23 with Ms. Tennyson. That's the reason for my puzzled
24 look.

25 JUDGE SCHAER: The Bench Request is due the

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1 28th. We have assigned a number to it, Exhibit 74, and
2 it has already been admitted. So I think whatever time
3 you come up with for dealing with subject to check might
4 also be a good time for you to use, if you have any
5 problems with how that exhibit looks, to try to resolve
6 those so you know what Exhibit 74 looks like as you go
7 into writing your briefs -- or as you go into your
8 briefs that are almost done.

9 MS. TENNYSON: Right.

10 JUDGE SCHAER: I want to thank everyone. I
11 think this hearing went very well, and I appreciate the
12 professionalism of the participants.

13 And with that, I think we're off the record.

14 (Hearing concluded at 4:55 p.m.)

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