

**Exhibit No. \_\_\_T (DPK-1T)**  
**Docket No. UW-060343**  
**Witness: Danny P. Kermode**

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**ILIAD WATER SERVICE, INC.,**

**Respondent.**

**DOCKET NO. UW-060343**

**RESPONSE TESTIMONY OF**

**DANNY P. KERMODE**

**STAFF OF  
WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION**

**RE: ILIAD WATER SERVICE'S REQUEST FOR  
ONE-TIME ASSESSMENT or SURCHARGE**

**October 4, 2006**

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## LIST OF EXHIBITS

- Exhibit No. \_\_\_\_ (DPK-2): Qualifications of Danny P. Kermode
- Exhibit No. \_\_\_\_ (DPK-3): Resume of Regulatory Experience of Danny P. Kermode
- Exhibit No. \_\_\_\_ (DPK-4): Company Schedule - Costs Included in 2004 Assessment
- Exhibit No. \_\_\_\_ (DPK-5): Staff Schedule of Costs of Chlorination Project in Docket UW-041830
- Exhibit No. \_\_\_\_ (DPK-6): Letter from Iliad Water Services, Inc., dated June 6, 2006, response to Data Request 3
- Exhibit No. \_\_\_\_ (DPK-7): Letter from Iliad Water Services, Inc., dated May 3, 2006, response to Data Request 2
- Exhibit No. \_\_\_\_ (DPK-8): DWSRF Financing Including Estimated Additional Project Costs.
- Exhibit No. \_\_\_\_ (DPK-9): Amortization Schedule with Present Value for Private Lender Loan
- Exhibit No. \_\_\_\_ (DPK-10): Amortization Schedule with Present Value for DWSRF Loan
- Exhibit No. \_\_\_\_ (DPK-11): Schedule to Compute DWSRF Loan – Monthly Surcharge
- Exhibit No. \_\_\_\_ (DPK-12): Staff Recommended Project Costs

1 I. INTRODUCTION

2

3 Q. Please state your name and business address.

4 A. My name is Danny P. Kermode. My business address is 1300 S. Evergreen Park  
5 Drive S.W., P.O. Box 47250, Olympia, WA 98504. My email address is  
6 dkermode@wutc.wa.gov.

7

8 Q. By whom are you employed and in what capacity?

9 A. I am employed by the Washington Utilities and Transportation Commission as a  
10 Regulatory Analyst.

11

12 Q. How long have you been employed by the Commission?

13 A. I have been employed by the Commission for ten years.

14

15 Q. Would you please state your educational and professional background?

16 A. I graduated in 1982 from Arizona State University in Tempe, Arizona with a  
17 Bachelor of Science in Accounting. Later that same year, I attended San Carlos  
18 University in the Philippines for postgraduate studies in Economic Analysis and  
19 Quantitative Business Analysis. I am a licensed Certified Public Accountant  
20 (CPA) in Washington.

21

22 In 1992 and 1993, I was a member of the faculty at the National  
23 Association of Regulatory Utility Commissioners (NARUC) Annual Regulatory  
Studies Program held at Michigan State University in East Lansing, Michigan. I

1 taught classes in Financial and Regulatory Accounting Standards and in Deferred  
2 Tax Accounting.

3 Exhibit No. \_\_\_\_ (DPK-2) is my professional resume and my regulatory  
4 experience is detailed in Exhibit No. \_\_\_\_ (DPK-3).

5

6 **II. SCOPE OF TESTIMONY**

7

8 **Q. What is the scope of your testimony?**

9 A. I testify regarding the tariff revision filed by the Iliad Water Service, Inc., (Iliad  
10 Water or Company) in this docket. I specifically address the nature of the one-  
11 time assessment proposed by the Company for a Department of Health required  
12 capital improvement. In my testimony, I discuss the cost of the improvement to  
13 its customers and the financing the Company selected to fund the improvement.  
14 In conjunction with the discussion of the Company's selected method of  
15 financing, I also review an alternative method of financing that was available to  
16 the Company prior to filing.

17

18 **III. SUMMARY OF TESTIMONY**

19

20 **Q. Please summarize your testimony.**

21 A. In my testimony I discuss Iliad Water's 2004 filing before the Commission and  
22 the issues Staff encountered in its audit. The testimony also discusses the results  
23 of Staff's review of current filing including the estimated project costs. My

1 testimony discusses Staff’s review of the financing method selected by the  
2 Company to finance a proposed Chlorination Project. I conclude the proposed  
3 financing is not in the interest of the ratepayers and recommend the Commission  
4 not allow the proposed tariff.

5

6 **IV. DISCUSSION**

7

8 **A. Background.**

9

10 **Q. Please briefly discuss Iliad Water.**

11 **A.** Iliad Water is a Commission regulated water company that owns three water  
12 systems; the Alder Lake Community Water System (Alder Lake water system) in  
13 southern Pierce County, Cascade Crest water system in Snohomish County and  
14 the Western Stavis water system in Kitsap County. The Company serves  
15 approximately 89 customers. The water system central to this case is the Alder  
16 Lake water system that serves the Alder Lake Estates residential community.

17 Iliad Water is a corporation owned by Derek Dorland. The Company is  
18 operated by a separate corporation, Iliad, Inc., which is owned by David Dorland  
19 Sr., Derek Dorland’s father.

20

21 **Q. When was the first time the Commission became aware of the Alder Lake  
22 assessment proposal?**

23 **A.** In August of 2004 the Company sent a letter to its customers under the heading of  
24 “Alderlake Water Company” [sic] citing the Alderlake Water Company’s water

1 service agreement. According to the letter, the water service agreement provided  
2 that customers pay for any upgrades required by a governmental agency. The  
3 letter stated that “Each customer will be required to make arrangements with the  
4 water company to pay for the improvement assessment of \$3,336.” *See Exhibit*  
5 *No. \_\_\_\_ (DD-5).*

6 In response to the letter, a number of Alder Lake customers contacted the  
7 Consumer Affairs Division of the Utilities Commission and complained. The  
8 Company responded stating that the letter was not a request for payment but  
9 rather a “survey” and that they were aware that any special assessments needed  
10 prior Commission approval.

11

12 **Q. In his testimony, Mr. Dorland refers to the “survey” as a “notice” to the**  
13 **customers. Do you consider it a notice as used by the Commission in the**  
14 **regulation of water companies?**

15 A. No. The Commission uses the term “notice” in WAC 480-110-425, Water  
16 company customer notice requirements. Notice, as used in the WAC, is the  
17 notification of customers of a pending request before the Commission to increase  
18 rates.

19

20 **Q. Provide an example of a requirement under WAC 480-110-425.**

1 A. Under Commission rules, a company is required to provide any proposed  
2 customer notice to the Commission for review at least one week prior to the  
3 planned printing date.<sup>1</sup>  
4

5 **Q. Did the Company provide a copy of its “notice” to the Commission prior to**  
6 **distribution?**

7 A. No.  
8

9 **Q. Does the notice rule have any required language that a Company must**  
10 **include in its notice?**

11 A. Yes. WAC 480-110-425(4) provides the specific required wording. For example,  
12 the notice must include information on how to contact the Commission and that a  
13 customer may offer comments in writing or personally at the Commission’s open  
14 meeting.  
15

16 **Q. Did the Company include any of the required wording?**

17 A. No.  
18

19 **Q. Do you believe it is correct to refer to the August 18, 2004, letter as a notice?**

20 A. No. I believe the use of the term “notice” to describe the letter mischaracterizes  
21 it. Clearly the letter was not the notice required in WAC 480-110-425.  
22

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<sup>1</sup> WAC 480-110-425 Water company customer notice requirements

1 **Q. How soon after the August 18, 2004, letter did the Company file the proposed**  
2 **assessment with the Commission?**

3 A. The Company filed the assessment on October 11, 2004, Docket UW-041830,  
4 proposing a \$3,265 one-time assessment to the Alder Lake water system  
5 customers. The tariff included the option to pay the assessment directly or over  
6 time using a private lender selected by the Company.<sup>2</sup> In other words, the  
7 customer would have to take out a loan with an outside third-party lender and pay  
8 the Company the one-time assessment up-front no matter which “option” the  
9 customer selected.

10

11 **Q. Were you assigned to review the 2004 filing?**

12 A. Yes.

13

14 **Q: To Staff’s knowledge, why is Iliad Water required to install a chlorination**  
15 **system?**

16 A: I understand that in the fall of 2000, the Alder Lake water system’s wells went  
17 dry, the result of low water levels in the nearby Alder Lake. In December of 2000,  
18 the Department of Health sent a letter to David Dorland, Sr., informing him that  
19 the water system was “clearly in hydraulic connection” to Alder Lake. *See Mr.*  
20 *Dorland’s Exhibit No. \_\_\_\_ (DD-2).* That is, the ground water that the water  
21 system uses to serve its customers has a hydraulic connection to the surface water  
22 in the lake, thus posing a microbial risk. As such, the Washington Administrative  
23 Code (WAC 246-290-640) requires the Company to install disinfection treatment.

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<sup>2</sup> BHL Investments, Inc., a private company located in San Rafael California, Ben Levine, president.

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Slightly over a year later, January 31, 2002, the Company received approval from the Department of Health of its proposed plan to chlorinate the Alder Lake water system. *See Exhibit No. \_\_\_\_ (DD-3).*

**Q: To Staff’s knowledge, why is Iliad Water seeking assessment from its customers?**

A. The assessment, as presented in both UW-041830 and this filing, reflects the Company’s choice to use its customers as the source of financing for the installation of the chlorination system. Normally, an investor owned company has a number of different options when considering how to finance a long-term capital improvement. A more customary financing would include a mix of equity capital and long-term debt. The resulting water utility plant is then included in rate base where the investor would earn a return on the equity investment over the life of the asset along with an interest return on the debt portion of the investment. The Company then depreciates the related plant in service over the life of the plant.

Since Iliad Water has a large negative retained earning of approximately \$150,000, with total assets of only \$90,000, the form of financing described above seems unlikely. The only viable option for financing is either through government sponsored loan programs or the customers themselves. The Company selected to finance the project with a surcharge on the customers. Through the assessment, the Company gives the Alder Lake water system

1 customers the choice of providing a pro rata share of the total cost of the project  
2 up-front or pay for it over 10 years while paying 11 percent interest.

3

4 **Q. What were the issues addressed in the 2004 Iliad Water filing?**

5 A. Staff had a number of concerns. Foremost was the cost of the project. Staff had  
6 concerns about the Company including many costs not related to the chlorination  
7 project, such as replacement of service mains, prior well drilling costs and water  
8 hauling costs.

9

10 **Q. Was financing an issue in the 2004 case?**

11 A. There were discussions regarding the Company using the Drinking Water State  
12 Revolving Fund (DWSRF) financing but it was not yet a central issue since Staff  
13 normally considers financing only after the total cost of a project is determined.  
14 In the 2004 case, the Company withdrew its filing prior to an agreement between  
15 Staff and the Company.

16

17 **Q. Did Staff have concerns regarding the bids received for the 2004 proposed  
18 project?**

19 A. Yes. The Company received one bid from a company owned by a family member  
20 and only two other bids from unrelated companies.

21

22 **Q. Please summarize the costs included in the 2004 assessment proposed by the  
23 Company and how they relate to the total cost of the project.**

1 A. A 2004 schedule provided by the Company that details the costs the Company  
2 proposed to include in its 2004 assessment. The total proposed cost of the project  
3 included recovery of costs already invested by the Company, and other costs not  
4 related to the required disinfection project. The total cost of the project, as  
5 proposed by the Company, was \$127,374 as shown in Exhibit No. \_\_\_\_ (DPK-4).  
6 Staff determined a cost of \$94,805, as shown on Exhibit No. \_\_\_\_ (DPK-5), Line  
7 25 column D.

8

9 **Q. What was the cost proposed by the winning bid to install the new**  
10 **chlorination system?**

11 A. Aerie Construction provided a bid for \$68,020 on August 23, 2004. *See Mr.*  
12 *Dorland's Exhibit No. \_\_\_\_ (DD-4), page 1.*

13

14 **Q. Was the proposed bid of \$68,020 included in the Staff's total cost of \$94,806?**

15 A. Yes, the \$68,020 is shown on line 13 of Exhibit No. \_\_\_\_ (DPK-5).

16

17 **Q. What was the resolution of the 2004 filing?**

18 A. The Company believed, because of the age of the bid, it needed to rebid the  
19 project and would refile a new case "in the near future." *See Mr. Dorland's*  
20 *Exhibit No. \_\_\_\_ (DD-13).* On June 7, 2005, the Commission issued an order  
21 dismissing the filing at the request of the Company.

22

23 **Q. Does the filing in this docket represent the promised filing?**

1 A. Yes.

2

3 **Q. Please discuss briefly the Company's current filing before this Commission.**

4 A. On March 1, 2006, Iliad Water filed with the Commission a tariff revision that is  
5 basically the same proposal as its 2004 proposal. It proposes to assess each of the  
6 39 customers on its Alder Lake water system a one-time charge of \$3,405 for the  
7 costs associated with installation of the same water chlorination system required  
8 by Department of Health regulations in the prior case. The assessment would  
9 provide full recovery of the Company's projected cost of the project, \$132,795.

10 Again, the assessment is restricted to only the customers on the Alder Lake water  
11 system and does not apply to customers of the other water systems owned by Iliad  
12 Water.

13

14 **Q. What are the issues you see in this filing?**

15 A. There are two main issues. The first issue is the cost of the proposed project. The  
16 second issue is the financing chosen by the management.

17

18 **B. Project Cost**

19

20 **Q. Has the Company provided support for its proposed project in this docket?**

21 A. Yes. Iliad Water provided copies of bids it received from three companies. The  
22 winning bid came from Iliad, Inc., which is the same company that operates Iliad  
23 Water under a maintenance agreement. The owner of Iliad, Inc., is David

1 Dorland, Sr., whom I understand is the Department of Health's primary contact  
2 person for the Alder Lake water system.

3

4 **Q. What was the bid by Iliad, Inc., to install the new chlorination system?**

5 A. On December 15, 2005, Iliad, Inc., provided a bid for \$108,164. *See Mr.*  
6 *Dorland's Exhibit No. \_\_\_\_ (DD-14).*

7

8 **Q. How does that compare to the low bid received from Aerie Construction in**  
9 **the 2004 bid?**

10 A. The bid received from Aerie Construction prior to the 2004 filing was for  
11 \$68,020. Iliad, Inc.'s, new bid represents a 59 percent increase in the cost to  
12 install the new chlorination system. This is a dramatic increase in costs,  
13 especially if you consider that the 2004 bid included the cost of the installation of  
14 35 water service connections that is not included in the new bid.

15

16 **Q. Does Staff have concerns of the limited number of companies bidding the**  
17 **project?**

18 A. Yes. In the 2004 case there were only two bids received for the project. The  
19 Aerie Construction bid, and a second company, Sun Industries, Inc., which is  
20 owned by David Dorland, Sr., who also owns Iliad, Inc. In this case, the company  
21 received only three. The low bid is from Iliad, Inc., the company that also  
22 operates Iliad Water.

23

1 **Q. Iliad Water also wants recovery of other costs in addition to the Iliad, Inc.,**  
2 **bid, what are they?**

3 A. Page 13 of the Company's Exhibit No. \_\_\_\_ (DD-14) shows three items,  
4 Engineering, "DOH Review Fee" and MPA Tests, totaling \$11,896. These are  
5 prior period costs, which the Company labels "Costs performed to date." In  
6 addition, it includes \$2,765 of further engineering costs and \$7,370 of financing  
7 and underwriter fees.

8  
9 **Q. On the same exhibit below the label "Costs performed to date," the Company**  
10 **has the notation "*Approved as construction costs by the WUTC.*" Are you**  
11 **aware of the Commission approving the costs cited in the schedule?**

12 A. No. The construction costs cited in the schedule have never come before the  
13 commission and have never been approved.

14  
15 **Q. The Company's Exhibit No. \_\_\_\_ (DD-14), Page 13 shows total capital costs of**  
16 **\$130,195. However, the proposed rates are based on \$132,795. What is the**  
17 **\$2,600 difference?**

18 A. The \$2,600 difference was the Company's estimate of legal costs associated with  
19 the Commission's approval of the project.

20

21 **Q. What is Staff's position on the costs incurred in prior periods?**

22 A. Staff takes the position that the costs in Mr. Dorland's Exhibit No. \_\_\_\_ (DD-14),  
23 page 13, under the caption "Costs performed to date" were already incurred and

1 are invested capital. The Company should recover those costs as normal  
2 investment over the life of the associated asset in the Company's basic water  
3 service rate, not in a surcharge or special assessment. That is, the costs related to  
4 prior engineering, Department Of Health Review Fee and "MPA tests" should be  
5 capitalized and recovered over the average life of the related water utility plant.

6

7

**C. One-time Assessment**

8

**Q. The Company's proposed tariff contains a provision that requires the  
9 customer to pay either a one-time assessment of \$3,405 or pay the assessment  
10 over time, is that correct?**

11

A. Yes.

12

13

**Q. Please describe the one-time assessment as proposed by the Company.**

14

A. The Company's proposed tariff provides the Alder Lake water system customers  
15 the option to pay \$3,405 within 30 days of the effective date of the proposed  
16 tariff.

17

18

**Q. Did you review the proposed one-time assessment of \$3,405?**

19

A. Yes.

20

21

**Q. Please describe how the \$3,405 was computed.**

1 A. The \$3,405 represents the total proposed cost of the project, \$132,795, divided by  
2 39, the total number of lots that the Alder Lake water system has the capacity to  
3 serve.

4  
5 **Q. Are you familiar with Washington Utilities and Transportation regulations,**  
6 **specifically WAC 480-110-455, Water company funding mechanisms?**

7 A. Yes.

8

9 **Q. Please describe your understanding of the regulation and its purpose.**

10 A. WAC 480-110-455 provides water companies under Commission regulation two  
11 general funding mechanisms, surcharges and facility charges. Although the  
12 surcharges address three financing methods, only two are relevant in this case:  
13 future water utility plant and current water utility plant. The rule provides that a  
14 company may collect a surcharge to (1) fund a reserve for a future capital project  
15 or, (2) service and repay debt used for the related financing for current water  
16 utility plant.

17

18 **D. Assessment Over Time**

19

20 **Q. If an Alder Lake customer lacks the ability to pay the one-time assessment,**  
21 **does the filed tariff allow other payment arrangements?**

22 A. Yes. The tariff, as originally filed in the prior case and this case, provided an  
23 option for customers to obtain a personal loan from a third party lender

1 recommended by Iliad Water. The original proposed private financing would  
2 have charged a customer 11 percent interest over 10 years, plus an origination fee  
3 of 3 percent to 5 percent of the loan principal.

4

5 **Q. Focusing only on this case, did the Company file an amended tariff that**  
6 **superseded the original tariff?**

7 A. Yes, the Company filed a substitute page replacing the originally filed tariff on  
8 August 15, 2006.

9

10 **Q. How is the substitute page different from the originally filed tariff?**

11 A. The substitute tariff retains the one-time assessment of \$3,405, but replaces the  
12 option of the customer obtaining individual private financing with the option of a  
13 monthly charge of \$49.26 over the next ten years. The Company refers to this as  
14 an “assessment over time.”

15

16 **Q. Did you review the proposed monthly charge, described as an “assessment**  
17 **over time”?**

18 A. Yes.

19

20 **Q. Please explain the “assessment over time” as proposed by Iliad Water.**

21 A. In the revised filing, the Company carries the debt itself and charges the  
22 customers selecting the “assessment over time” option \$49.26 per month for ten  
23 years. The Company’s filing appears consistent with the requirements of WAC

1 480-110-455 (2) Surcharges. The Company would use the funds received from  
2 the “assessment over time” (better described as a surcharge), to service the related  
3 debt. The funds would repay principal and interest charges.

4

5 **Q. Of the proposed \$49.26 surcharge, how much of the monthly payment is**  
6 **related to servicing interest charges.**

7 A. Initially, the interest component makes up approximately 65 percent of the total  
8 payment. In the first year, interest makes up \$30.40 of the average \$49.26  
9 payment. Interest, as a component of the total payment, will slowly decrease over  
10 the life of the debt. More than one half of each monthly payment will consist of  
11 interest until late into the fourth year of the loan.

12

13 **Q. Explain the timing of the proposed collection of the one time assessment and**  
14 **surcharge with respect to the usefulness of the proposed chlorination system.**

15 A. In this filing, the Company proposes to collect an assessment within 30 days of  
16 the effective date of the tariff, or collect a monthly surcharge for customers not  
17 paying the assessment immediately upon the next billing cycle. Only then will  
18 the Company begin construction of the new chlorination system. The result of the  
19 Company’s proposal is the Company will begin recovery of the cost of the  
20 chlorination plant before the plant is constructed or used and useful.

21

22 **Q. Is the inclusion in rates of costs for utility plant that is not yet built consistent**  
23 **with Washington regulatory ratemaking practices?**

1 A. No. Normally, utility plant is placed in service prior to the collection of rates.  
2 That way, the customer pay for the service they receive. It is common for Staff to  
3 remove water plant that is under construction from rate base to prevent its early  
4 recovery in current rates.

5 It is only under rare circumstances that the Commission has allowed  
6 recovery of plant not yet used and useful only in rare circumstances. In a prior  
7 Commission order, the Commission noted its “judicial reluctance” to include  
8 Construction Work in Progress in rates.<sup>3</sup>

9

10 **Q. Please describe the financing the Company proposes to use for the water**  
11 **chlorination system.**

12 A. The Company has arranged financing with the same private lender that it had  
13 proposed for its customers under its original tariff. Indeed, the proposed  
14 financing is under the same terms, that is, 11 percent interest over 10 years, plus  
15 an origination fee of 3 percent to 5 percent of the loan principal.

16

17 **Q. Was there more favorable financing available to Iliad Water?**

18 A. Yes, privately owned water companies have access to low-cost loans from the  
19 Washington State’s Drinking Water Revolving Fund. A loan from the Drinking  
20 Water State Revolving Fund (DWSRF) provides funds for projects over a 20 year  
21 period at below market rates. For example, in 2006, the DWSRF program  
22 provided loans at 1.5 percent interest. *See Sarver Exhibit No. \_\_\_\_ (RS-8), Page 9.*

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<sup>3</sup> Olympic Pipe Line *WUTC v. Olympic Pipe Line Company*, Docket No. TO-011472, Twelfth Supplemental Order (September 27, 2002) at 89.

1 An interest rate this low would result in a significant savings for the Alder Lake  
2 water system customers compared to the 11 percent interest proposed by the  
3 Company.

4

5 **E. Optimal Financing**

6 **Q. Please discuss how you conclude that the ratepayer would experience a**  
7 **significant savings if the Company used funding from the DWSRF compared**  
8 **to the financing provided by a private lender.**

9 A. To measure the savings to the ratepayer, I used a present-value technique. Present  
10 value allows comparison of financing alternatives with different repayment  
11 periods and interest rates, exactly like the two alternatives in this case. The  
12 analysis computes the amount of money a customer would need “up-front” to  
13 fund all future cash payments related to the alternative proposed methods of  
14 financing, assuming that customers earn a reasonable return on the up-front  
15 money until each loan payment is made.

16 As a simple example, assume a customer must make a single loan  
17 repayment of \$100 at the end of the year. Also assume the customer can earn an  
18 average of 8 percent return. A present value computation derives the amount of  
19 money the customer needs at the beginning of the year to make the \$100 payment  
20 at the end of the year. The present value of \$100 at 8 percent is \$92.59.

21

22 **Q. Please explain how an analyst would use the values derived in the present**  
23 **value analysis to determine the optimal financing.**

1 A. Once the present values are computed for each financing method, the analyst  
2 compares the values. The financing method with the lowest present value is the  
3 optimal financing method. That is, the option that provides the lowest cost to the  
4 customers over the life of the loan is the best financing method.

5  
6 **Q. In this case, does the Company's failure to select the optimal financing affect  
7 only those customers who select the surcharge option?**

8 A. No, the choice of the optimal financing affects both those customers who select a  
9 monthly surcharge and those customers who may consider selecting the one-time  
10 charge. The choice of whether to take a second mortgage or withdraw money  
11 from savings to pay for the one-time option depends greatly on the opportunity  
12 costs. For example, if customers can obtain the funds to pay the assessment up  
13 front by using their house as security for an interest rate of, hypothetically, 6  
14 percent it would be in their advantage to do so since the surcharge has an  
15 embedded rate of 11 percent. However, if the surcharge has an embedded rate of  
16 1.5 percent it would be more beneficial to bypass obtaining a 6 percent loan and  
17 pay the monthly surcharge.

18  
19 **Q. Did you perform a present value analysis comparing the private debt  
20 proposed by the Company to funds provided by the State of Washington  
21 through the DWSRF?**

22 A. Yes.

23

1 **Q. Were there any additional assumptions that were required to fairly compare**  
2 **the two?**

3 A. Yes there was. A company that receives a DWSRF loan incurs a number of  
4 additional costs that a company may not incur with a private loan. For example, a  
5 company must pay its labor at the prevailing wage for the area, plus there are  
6 environmental review fees and possible costs of an archeological survey.

7  
8 **Q. How did you estimate the additional cost associated with the DWSRF loan.**

9 A. Staff's Data Request 3, *see Dorland Exhibit No. \_\_\_\_ (DD-16), page 6*, asked the  
10 Company to provide a detailed analysis of the increased costs it believed it would  
11 incur had it selected DWSRF financing. In its response, Iliad Water provided a  
12 listing of its estimates of the additional costs, *see Dorland Exhibit No. \_\_\_\_ (DD-*  
13 *16), page 9-10, and my Exhibit No. \_\_\_\_ (DPK-6)*. My Exhibit No. \_\_\_\_ (DPK-8)  
14 shows the additional costs added to the amount proposed by the company,  
15 adjusted for financing costs, to compute the amount that the Company would need  
16 to finance if it used DWSRF financing.

17  
18  
19 **Q. What was the result of your analysis?**

20 A. I computed present value amounts for both the proposed private financing and the  
21 DWSRF financing, assuming 100 percent of the project was financed.<sup>4</sup> My  
22 Exhibit No. \_\_\_\_ (DPK-9), line 22 shows the computed present value for the 11

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<sup>4</sup> The results would change based on the percent of customers who would decide to pay the surcharge versus the one-time charge. However, the conclusion would remain the same since the relationship between the two methods would remain the same.

1 percent private debt proposed by the Company was \$147,293 whereas the present  
2 value of the DWSRF Financing shown on my Exhibit No. \_\_\_\_ (DPK-10), line 30  
3 was \$91,700. Since the DWSRF financing produced the lowest present value, the  
4 DWSRF is the optimal method of financing this project.

5  
6 **Q. Did Staff perform an analysis of the impact on the proposed surcharge if a**  
7 **DWSRF loan was used instead of private financing?**

8 A. Yes. My analysis on my Exhibit No. \_\_\_\_ (DPK-11) shows the surcharge would  
9 decrease to \$21.53 a month for 20 years. A significant decrease considering the  
10 Company is proposing \$49.26 a month for 10 years using private financing.

11  
12 **F. Failure to Pursue State Revolving Fund**

13 **Q. Are you aware of why the Company says it did not pursue a DWSRF loan?**

14 A. Yes. In his filed testimony, Mr. Dorland states that he did not pursue a DWSRF  
15 loan to finance this project after discussions with the Company's engineer. *See*  
16 *Mr. Dorland's Exhibit No. \_\_\_\_ (DD-1T), page 8, Lines 16-17.*

17 The Company stated in response to Staff's Data Request 1, *Exhibit No.*  
18 *\_\_\_\_ (DD-16), page 2, Item 5*, that its engineer did an "extensive investigation"  
19 and determined a DWSRF loan was not economical due to both increased costs  
20 and the increased time in implementing the loan and construction requirements.  
21 *See Mr. Dorland's Exhibit No. \_\_\_\_ (DD-16), page 4, Item 5.*

22 Although the Company stated its engineer did an "extensive  
23 investigation," when asked for a copy of the study in Staff's Data Request 2,

1            *Exhibit No. \_\_\_\_ (DD-16), page 5, the Company responded that there was no*  
2            *formal study or correspondence because the discussions had been verbal. See*  
3            *Exhibit No. \_\_\_\_ (DPK-7), Item 1.*

4                       The Company has not provided any contemporaneous correspondence,  
5            studies or analysis indicating an “extensive investigation” of either the private  
6            loan or a DWSRF loan. In fact, the Company has provided no correspondence  
7            prior to May 3, 2006, when the Company responded to Staff’s data request, in its  
8            attempt to support its position that it relied on the engineer’s conclusion that  
9            increased costs would off-set any DWSRF loan savings in making its decision not  
10           to finance using the DWSRF.

11

12    **Q.    In Staff’s opinion, has Iliad Water justified its position that additional costs**  
13           **of pursuing a DWSRF loan would not offset any DWSRF loan savings?**

14    A.    No. While the Company, in its response, provided an expansive listing of  
15           additional costs Iliad Water expected it would incur if it obtained DWSRF  
16           financing, it provided no analysis supporting its position.

17

18    **Q.    In its response to Data Request 3, see Dorland Exhibit No. \_\_\_\_ (DD-16), page**  
19           **6, the Company stated that its engineer advised the Company that Iliad**  
20           **Water could not obtain a DWSRF loan because the Company is a “for**  
21           **profit” water system. Do you agree?**

22    A.    No. The Company’s engineer, Mr. McDonnell, states in his letter: “I do not see  
23           how Alder Lake can qualify for State funding as a private ‘for profit’ system. As

1           you know the guidelines clearly define eligibility as ‘community and nonprofit  
2           non-community water systems.’”

3           The Alder Lake water system is both a community water system and  
4           privately owned, neither of which disqualifies the Company for DWSRF  
5           financing. The Washington Department of Health clearly states in its DWSRF  
6           guidelines, *see Mr. Sarver’s Exhibit No. \_\_\_\_ (RS-8), Page 13, Item 1*, under the  
7           section titled Eligible and Ineligible Applicants: “Publicly and privately owned  
8           water systems in Washington State may apply for a [DWSRF] loan to assist in  
9           financing water system projects that address public health risk and systems that  
10          are out of compliance....”

11          Contrary to the opinion of the Company and its engineer, Iliad Water is  
12          eligible for DWSRF financing as a private for profit system.

13

14

15

16

17

18

### **G. Single-Tariff Pricing for Water Companies**

19

20   **Q.    To your knowledge, has the Commission allowed recovery of the costs of**  
21   **system improvements that are required by the Department Of Health?**

22   **A.    Yes, the Commission has consistently allowed recovery of the costs of system**  
23   **improvements required by the Department Of Health.**

1

2 **Q. Does the Commission normally allow increased rates for all customers served**  
3 **by the same company to pay the costs of system improvements on just one**  
4 **water system?**

5 A. Yes. This type of rate design is commonly referred to as Single-Tariff Pricing.  
6 The Commission has consistently supported Single-Tariff Pricing since it  
7 normally distributes the risk of the individual water customer in much the same  
8 way as an insurance pool and diminishes the impact of major investments on the  
9 individual customer. Under Single-Tariff Pricing, some customers pay more and  
10 some customers pay less than rates set on a stand-alone cost basis.

11

12 **Q. How many water systems does Iliad Water own and how many customers do**  
13 **those water systems serve?**

14 A: As I stated above, Iliad Water serves approximately 89 customers on three water  
15 systems. The three water systems are the Western Stavis water system in Kitsap  
16 County, the Cascade Crest water system in Snohomish and the Alder Lake water  
17 system in southern Pierce County near the town of Elbe.

18

19 **Q. Should the cost of the chlorination system for the Alder Lake water system**  
20 **be shared among the customers of all the water systems?**

21 A. No, not in this case. When the number of customers a company serves is  
22 relatively large, the impact of Single-Tariff Pricing on customers on other systems  
23 is normally small.

1                   However, in this case, there are a total of only 89 customers on all three  
2 systems. Fifty of the customers are not on the system receiving the chlorination.  
3 If the proposed surcharge was spread evenly to all customers, all customers would  
4 receive a \$21.58 rate increase. The \$21.58 surcharge equals 86 percent of the  
5 average monthly water bill for the Cascade Crest water system customers and 93  
6 percent of the average monthly water bill for the Western Stavis water system.

7                   Review of surcharges the Commission has previously allowed shows that  
8 the average impact of surcharges of regulated water companies range is between  
9 15 percent to 23 percent of a ratepayer's average bill. Although Single-Tariff  
10 Pricing is normally used in providing surcharges, due to the materiality of the  
11 proposed surcharge, Staff supports allowing the surcharge to apply to only  
12 customers on the Alder Lake water system.

13

14

## V. CONCLUSION

15

16 **Q. Does Staff support the Department of Health's requirement to install**  
17 **chlorination on the Alder Lake water system?**

18 A. Yes. The Department of Health is responsible for assuring the public receives  
19 both safe and reliable drinking water.

20

21 **Q. Does Staff recommend the Commission accept the Company's proposed**  
22 **tariff?**

1 A. No. Although the Staff supports the Department of Health and its requirement  
2 that the Company install chlorination, Staff does not support the Company's  
3 proposed financing. The proposed financing provides recovery of estimated costs  
4 prior to the construction of the system and the method of financing selected by the  
5 Company burdens the Alder Lake water system customers with unreasonable  
6 financing costs.

7

8 **Q. In your professional opinion, should this financing proposal be approved?**

9 A. No. In my opinion, the Company, and/or its engineer, did not perform the proper  
10 analysis of the alternatives available to its customers. My analysis clearly shows  
11 that the DWSRF loan program was available to Iliad Water and the Company's  
12 decision to finance through a private lender harms the customers on the Alder  
13 Lake water system.

14

15 **Q. Is Staff suggesting that the chlorination system required by the Department  
16 of Health is not a prudent investment by the Company?**

17 A. No. The Company should install the chlorination system because it is important  
18 to the health and safety of the customers on the Alder Lake water system. Staff's  
19 position is that the Company's proposed method of financing is imprudent. Staff  
20 also has not found any support that the Company performed the proper due  
21 diligence in its selection of the proposed financing.

22 The financing would put an unfair burden on the customers on its Alder  
23 Lake water system simply because of the Company failed to pursue financing

1 with the DWSRF. The burden remains regardless of the Company's assertions  
2 that it relied on its engineers. The Company is in the business of providing water,  
3 Staff believes it is reasonable to expect the Company to know its eligibility to  
4 obtain DWSRF funds.

5  
6 **Q. If the Commission found that the financing was acceptable, what is your**  
7 **recommendation of the recovery of costs?**

8 A. The Company should recover only the costs associated with future improvements  
9 to the water system, the \$11,896 of costs shown on page 13 of the Company's  
10 Exhibit No. \_\_\_\_ (DD-14) are related to prior periods and should not be allowed  
11 for recovery since they are costs already incurred and financed. Staff  
12 recommends the Commission allow \$125,183 as shown on line 17 of  
13 Exhibit No. \_\_\_\_ (DPK-12).

14  
15 **Q. What would be the amount of the one-time assessment and surcharge if the**  
16 **Commission allowed recovery of the \$125,183?**

17 A. The one time assessment would be \$3,210 and assuming the same 11 percent  
18 interest over 10 years loan terms the monthly surcharge would decrease to \$46.44.

19  
20 **Q. Does this conclude your testimony?**

21  
22 A. Yes it does.