

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

AMERICAN WATER RESOURCES,
INC.,

Respondent.

DOCKET NO. UW-031284

DOCKET NO. UW-010961

DOCKET NO. UW-031596
(consolidated)

REPLY BRIEF ON BEHALF OF COMMISSION STAFF

July 9, 2004

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I. INTRODUCTION

1 This case involves a company that the Commission and Staff have worked with extensively since American Water Resources, Inc., (AWR) came under the Commission's jurisdiction. Certain requirements, such as quarterly budget reports, were imposed to assist AWR in managing its revenues and expenses.¹ The Docket 010961 Account requirements were placed on AWR to ensure proper use of funds received in rates.

2 AWR now argues it is not being treated as the Commission treats other water companies it regulates.² The Commission has applied the appropriate regulatory response to AWR's situation. For example, the Docket 010961 Account was created when the Commission approved rates for a third time that included funds supporting future employees. Because AWR had a history of requesting funds for future employees, then not hiring or maintaining the employees, the Commission imposed restrictions on the Docket 010961 Account funds.³ Simply because other water companies have not had similar docket account requirements placed on them does not indicate that AWR is being treated unfairly.

3 In arguing that the Commission acted unfairly by restricting the use of the funds, AWR ignores the fact that the Commission has not approved similar funds

¹ Eckhardt, Tr. 108:15-20.

² AWR Brief at 5.

³ AWR acknowledges this history. AWR Brief at 12-13.

for any other regulated water company. The Docket 010961 Account and the prior two allowances for future employees consisted of a more creative regulatory treatment to address a specific issue. Over the past several years, it has become apparent that more creative regulation does not work well with AWR.⁴ Thus, Staff recommends applying sound, traditional ratemaking techniques in this case.

4 AWR argues that traditional regulation does not work for small companies.⁵ The Commission regulates approximately 70 water companies in Washington, and many of those companies are smaller than AWR.⁶ Those companies do not seem to have the same struggles as AWR.⁷ Traditional regulation seldom is to blame when utilities struggle, but rather misunderstanding regulatory principles and process can hinder a utility's success. For example, expecting ratepayers to pay in advance for capital improvements and other expenses will lead to frustration for the utility because ratepayers are typically not required to pay in advance for those items.

5 Mr. Fox testifies that he understands utilities typically invest money upfront, then recover amounts in rates, and ratepayers do not typically pay in advance.⁸ However, AWR argues Staff's recommendation does not provide funds for future, estimated capital expenditures. For example, AWR argues funds are not provided

⁴ Staff Brief at 17.

⁵ AWR Brief at 7.

⁶ For example, the Commission regulates Aquarius Utilities, Burton Water Company, Canterwood Water Company, Estates Water Systems, Kala Point Utility Company, Stroh's Water Company, and Tall Timber Water Systems.

⁷ Eckhardt, Ex. 30T at 41:15-17.

⁸ Fox, Tr. 253:16-21.

for engineering studies to update its Comprehensive Water Plan, for updating its water system plan and SMA filings, for capital improvements identified by its Capital Improvement Plan, and for meeting new legislative requirements.⁹ AWR's argument requires ratepayers to pay for capital improvements in advance and is contrary to regulatory theory.

6 The rates proposed by Staff in this case allow AWR to recover reasonable and prudently incurred expenses and the opportunity to earn a fair return on rate base prudently devoted to public service. The Commission should adopt Staff's recommendation that AWR's rates are excessive.

7 Likewise, the Commission should reject Mr. Fox's application for mitigation because Mr. Fox failed to establish sufficient mitigating factors. The Commission should require Mr. Fox to pay the full penalty amount within 15 days from entry of the final order in this matter.

8 This brief first discusses issues relating to the rate case, then issues relating to the penalty assessment against Mr. Fox.¹⁰

⁹ AWR Brief at 3-4.

¹⁰ To the extent issues are not discussed in this Reply Brief, Staff relies on the arguments set forth in its Opening Brief. To the extent issues are discussed here, this brief augments Staff's Opening Brief.

II. RATE CASE ISSUES

9 Rate case issues addressed by this brief are the Docket 010961 Account issue, expense issues, and rate base issues. In addition, Staff addresses certain miscellaneous issues raised in AWR's Opening Brief.

A. **Docket 010961 Account**

10 In its brief, AWR mischaracterizes Staff's recommendation regarding the Docket 010961 Account.¹¹ AWR argues that Staff proposes the Docket 010961 Account now be treated as a regulatory liability. AWR's argument fails to recognize that the regulatory liability arose in Docket No. UW-010961 when the Account was created. The issue now before the Commission is how to dispose of the Docket 010961 Account funds because AWR cannot use them in the manner ordered in the Order Approving Settlement Agreement.¹² Staff's recommendation gives effect to the purpose for which the funds were originally collected.¹³

11 AWR argues it should not be required to apply amounts equal to money already spent or never deposited into the Docket 010961 Account to offset employee expenses.¹⁴ As support, AWR argues using money from the Docket 010961 Account

¹¹ AWR Brief at 22-25.

¹² Ward, Ex. 45, *WUTC v. American Water Resources, Inc.*, Docket No. UW-010961, Order Approving Settlement Agreement (December 18, 2001) (Order Approving Settlement Agreement).

¹³ Staff Brief at 7-14.

¹⁴ The money missing from the Docket 010961 Account totals \$73,351, which is the sum of funds AWR improperly spent (\$68,061) and funds AWR never deposited but collected from customers (\$5,290). Staff Brief at 14, note 51. The two-year amortization amount associated with the missing money is \$36,675 annually. *Id.* The total amount of the regulatory liability (cash currently in the

to pay capital gains tax on gain from the View Royal sale was proper because “the funds...were used to reduce debt pursuant to Commission direction,”¹⁵ referring to the orders in the *Consolidated 1998 Dockets*.¹⁶

12 In the *Consolidated 1998 Dockets*, the Commission evaluated AWR’s capital structure in both the initial order (Fifth Supplemental Order) and the final order (Sixth Supplemental Order). In that case, AWR’s capital structure included more than 90 percent debt.¹⁷ The Commission imposed a hypothetical capital structure of 80 percent debt and 20 percent equity to encourage Mr. Fox to move AWR toward a more balanced capital structure.¹⁸ The Commission noted that it would evaluate AWR’s capital structure in future rate cases.¹⁹

13 The Commission did not instruct Mr. Fox to retire all of his debt in favor of equity and to move AWR toward an equity rich capital structure. Indeed, the Commission noted that, although equity rich companies are inherently safe, they subject customers to unnecessarily higher rates due to higher capital costs.²⁰ Rather,

account plus the missing money) is \$125,113, and the total amortization amount is \$62,557. Staff Brief at 12.

¹⁵ AWR Brief at 23.

¹⁶ See AWR Brief at 17-19; *WUTC v. AWR*, Docket Nos. UW-980072, UW-980258, UW-980265 (Consolidated) (Consolidated 1998 Dockets).

¹⁷ *WUTC v. AWR*, Consolidated 1998 Dockets, Sixth Supplemental Order at 5 and 34 (Finding of Fact No. 17).

¹⁸ *WUTC v. AWR*, Consolidated 1998 Dockets, Fifth Supplemental Order at 22-24; *WUTC v. AWR*, Consolidated 1998 Dockets, Sixth Supplemental Order at 8-10.

¹⁹ *WUTC v. AWR*, Consolidated 1998 Dockets, Fifth Supplemental Order at 24; *WUTC v. AWR*, Consolidated 1998 Dockets, Sixth Supplemental Order at 9.

²⁰ *WUTC v. AWR*, Consolidated 1998 Dockets, Sixth Supplemental Order at 9. Reducing the amount of equity in an equity rich capital structure can be done without sacrificing safety.

the Commission instructed Mr. Fox to improve AWR's capital structure to one that is more stable and balanced. The Fifth Supplemental Order stated, "The Commission's goal, then, must be to encourage AWRI to change its capital structure to improve the company's financial structure and stability."²¹ The Commission sent an "encouraging signal that [it expected] AWRI to balance debt and equity and [would] reward that decision."²²

14 Thus, Mr. Fox was not acting "pursuant to Commission direction" when he applied the entire amount of the sales proceeds to reducing debt AWR owed to him. Moreover, interpreting the Commission's Fifth Supplemental Order and Sixth Supplemental Order from the *Consolidated 1998 Dockets* as directing AWR to sell its largest most profitable water system, causing a significant cash flow deficit for the Company, is not a reasonable interpretation.²³

15 In any event, using the Docket 010961 Account funds to pay the tax on gain from View Royal was improper because the funds were never intended to pay tax.²⁴

16 AWR also argues that it should not be required to amortize the missing Docket 010961 Account money because the money was used to pay taxes on the Account itself.²⁵ AWR points to Mr. Ward's testimony during cross-examination

²¹ *WUTC v. AWR*, Consolidated 1998 Dockets, Fifth Supplemental Order at 23.

²² *Id.*

²³ The Commission has attempted to address AWR's misreading of the *Consolidated 1998 Dockets* issues. See *WUTC v. AWR*, Consolidated 1998 Dockets, Sixth Supplemental Order at 8 and 12.

²⁴ Staff Brief at 9.

²⁵ AWR Brief at 23-24.

regarding how Staff would treat penalties that may result from a subsequent IRS audit.²⁶

17 Companies are not penalized for requesting tax refunds from the IRS. If the IRS conducts a subsequent audit and uncovers other items subject to penalty, those penalties may not be appropriately borne by ratepayers. AWR acknowledges in this case that IRS penalties should be removed from rates.²⁷ In any event, it is highly speculative to assert that the IRS will conduct an audit due to AWR's refund request and that the audit would result in penalties. Moreover, how penalties are treated *vis a vis* rates is irrelevant to the question of how the Docket 010961 Account funds should be treated.

18 AWR argues that Staff ignored the proposals AWR made regarding the Docket 010961 Account funds.²⁸ Staff did not ignore the proposals. Staff disagreed with the proposals because they did not reflect sound regulatory treatment, and Staff informed AWR of its position. Mr. Eckhardt testified the proposals were presented with no supporting justification, and he indicated to the Company that additional analysis was required before changes to the conditions on the Docket 010961 Account could be made.²⁹ AWR did not provide additional analysis and further chose to prevent the Commission from deciding the matter when it

²⁶ *Id.*; Ward, Tr. 149:4-19; *See also* Ward, Tr. 175:18 to 176:5.

²⁷ *See* Parker, Ex. 100T at 10:1-9; Ward, Ex. 40T at 12:12 to 13:6.

²⁸ AWR Brief at 24.

²⁹ Eckhardt, Ex. 30T at 37:10-13.

withdrew its request to modify the Order Approving Settlement Agreement in January 2003.³⁰

19 AWR argues Staff's Docket 010961 Account recommendation "has the look and feel of retroactivity."³¹ To the contrary, Staff's recommendation complies with the rule against retroactive ratemaking.

20 The rule against retroactive ratemaking prohibits the Commission from setting future rates to allow a utility to recover past losses or disgorge excessive profits.³² The rule against retroactive ratemaking is not violated when the Commission directs treatment of funds at the outset.³³ In this case, the Commission directed the use of the Docket 010961 Account funds: AWR was required to use the money to hire two additional employees.

21 By directing the use in the first instance, AWR had notice that the money was restricted and would not be available for general use. This is analogous to the Commission setting rates subject to refund. The rationale preventing subsequent refunds from violating the rule against retroactive ratemaking is the utility and

³⁰ Ex. 140; Ex. 141.

³¹ AWR Brief at 25.

³² See *Town of Norwood, Mass v. FERC*, 53 F.3d 377, 381 (D.C. Cir. 1995); *East Tennessee Natural Gas Company v. FERC*, 631 F.2d 794, 800 (DC Cir 1980).

³³ Examples of regulatory treatment not constituting retroactive ratemaking are rates subject to refund and collection of deferred costs so long as the costs were intended to be deferred all along. See *Friends of the Earth v. Public Service Comm'n*, 254 N.W.2d 299, 308-309 (Wis. 1977); *Norwood*, 53 F.3d at 383.

ratepayers have notice that refunds may be ordered, and the Commission has not fully exercised its ratemaking authority.³⁴

22 In addition, it is not retroactive ratemaking for a commission to order a utility to honor its tariff when the tariff calls for an adjustment in rates, such as a PGA.³⁵ The settlement agreement approved by the Commission in Docket No. UW-010961 is analogous. The Commission ordered AWR to use the funds for a specific purpose. The funds cannot be used for that specific purpose, and allowing AWR unrestricted access to the money would result in a windfall because the Commission previously found that the rate minus the set aside amount was sufficient to operate. Thus, should the Commission adopt Staff's recommendation, it would be ordering AWR to comply with the Order Approving Settlement Agreement by using the funds for a dedicated purpose.

23 Staff's recommendation regarding the regulatory liability is appropriate. It gives effect to the purpose for which the funds were originally collected from ratepayers while benefiting the Company.³⁶ The Commission should adopt Staff's recommendation as set forth in testimony and Staff's Opening Brief.³⁷

³⁴ See *Friends of the Earth*, 254 N.W.2d at 308-309.

³⁵ See *East Tennessee*, 631 F.2d at 800.

³⁶ Staff Brief at 11-14.

³⁷ See Staff Brief at 12.

B. Expenses

24 This brief addresses employee expenses³⁸ and cost of living allowance (COLA),³⁹ manager salary,⁴⁰ site assessment,⁴¹ rate case expenses,⁴² and pro forma debt adjustment.⁴³

1. Pro Forma Adjustment P-3: Employee Expenses, and Pro Forma Adjustment P-10: COLA

25 AWR agrees with Staff's alternative recommendation for Pro Forma Adjustment P-3 (employee expenses), which allows in rates the equivalent of full time compensation for the six employees AWR currently employs.⁴⁴ AWR argues Staff's primary recommendation of including the test period amounts for the six employees "just proves Mr. Fox's point that it appears that Commission Staff is out to harm the company."⁴⁵ Staff's recommendations, interpretations, and actions in this case are not personal towards either the Company or Mr. Fox.⁴⁶ In addition, nothing in Staff's recommendations, interpretations, and actions in this case is malicious or ill intended.⁴⁷

³⁸ Pro Forma Adjustment P-3.

³⁹ Pro Forma Adjustment P-10.

⁴⁰ Pro Forma Adjustment P-6.

⁴¹ Pro Forma Adjustment P-8.

⁴² Pro Forma Adjustment P-9.

⁴³ Pro Forma Adjustment P-4.

⁴⁴ AWR Brief at 11-13; Staff Brief at 17-18.

⁴⁵ AWR Brief at 12.

⁴⁶ Eckhardt, Ex. 30T at 5:12-14.

⁴⁷ AWR baselessly accuses Staff of intending to harm or mislead the Company in several of its arguments. See AWR Brief at 5, 6 (note 6), 7, 12, 14, 15 (note 74), 17, and 24. AWR's accusations are preposterous, unfounded, and unreasonable.

26

Staff's approach to this case, as with all cases, is based on Staff's understanding of the proper regulatory treatment of the issues.⁴⁸ Staff's primary recommendation regarding AWR's employee expenses is based on the regulatory principle that rates are based on historical cost.⁴⁹ The recommendation is reasonable, not punitive.

27

Regarding Pro Forma Adjustment P-10 (employee COLA), AWR misrepresents Mr. Ward's testimony on cross-examination.⁵⁰ Mr. Ward testified that a COLA might be appropriate depending on the economic conditions, but not as a matter of course.⁵¹ When asked whether he would "just accept" the COLA as a pro forma adjustment, Mr. Ward stated he would have to review it.⁵² Because AWR's proposed adjustment was late-filed and not subject to discovery, Mr. Ward's response was reasonable. Staff cannot accept any adjustment without conducting due diligence of reviewing the adjustment. In any event, AWR has not demonstrated that Adjustment P-10 is appropriate, and the Commission should disallow it.⁵³

⁴⁸ Eckhardt, Ex. 30T at 5:14-18.

⁴⁹ *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310, 109 S. Ct. 609, 102 L.Ed.2d 646 (1989).

⁵⁰ AWR Brief at 12.

⁵¹ Ward, Tr. 139:19-22.

⁵² Ward, Tr. 140:1-10.

⁵³ See Staff Brief at 32.

2. Pro Forma Adjustment P-6: Manager Salary

28 AWR argues the amount in rates included for Mr. Fox's salary should be increased. As support, AWR cites improvement of customer service and a comparison of the amount requested with salaries paid by other water companies.⁵⁴ Neither item is sufficient to justify increasing Mr. Fox's salary.

29 Customer service issues seem to have been positively resolved.⁵⁵ The customer service issues were improved after the Department of Health (DOH) issued compliance orders and penalties to ensure certain public health problems were remedied. Issuing compliance orders and penalties is fairly uncommon for DOH.⁵⁶ In addition, the Commission's approval of a surcharge to fund capital improvements on 13 critical water systems in the Docket No. UW-990518 aided in resolving customer service issues. Thus, positive resolution of AWR's customer service issues was achieved through regulatory action of at least two state agencies.

30 Even though customer service issues have improved, the decisions made by Mr. Fox have been consistently harmful to AWR and its customers.⁵⁷ AWR ignores the quality of Mr. Fox's decisions in recommending Adjustment P-6.

31 The record is replete with examples of mismanagement.⁵⁸ Mr. Fox has paid himself a higher salary than was allowed in rates.⁵⁹ Mr. Fox also received 12

⁵⁴ AWR Brief at 9-11.

⁵⁵ Staff Brief at 23.

⁵⁶ Lahmann, Ex. 1T at 7:19 to 8:2 and 18:8 to 20:10.

⁵⁷ Staff Brief at 23.

percent interest on debt owed to him by AWR when only 10.5 percent interest was included in rates.⁶⁰ Paying Mr. Fox a higher salary and higher interest than allowed in rates would result in a loss for accounting purposes. Thus, Mr. Fox's mismanagement contributed to any losses AWR incurred.

32 Mr. Fox hired Mitch Myers as AWR's manager. Although Mr. Fox states Mr. Myers was "a thoroughly experienced manager in the water industry,"⁶¹ Mr. Myers had no experience managing a water company, let alone a regulated water company. Mr. Myers was a salesman.⁶² AWR has been subject to compliance orders and penalty assessments from DOH for failure to maintain its water systems in compliance with DOH standards.⁶³ Customers of AWR's Crowder water system successfully sued the Company after enduring months of "boil water notices."⁶⁴ Mr. Fox treated AWR's line of credit as a standard loan, ultimately causing the bank to convert it to a standard loan, and AWR's ability to respond to unplanned capital expenditures may be limited. Mr. Fox's decisions expose a long history of mismanagement and supports rejecting AWR's proposed adjustment.

33 Additionally, comparison with other companies does not render AWR's proposed adjustment reasonable. The Commission evaluates adjustments

⁵⁸ Staff's Opening Brief describes a number of the mismanagement examples. Staff Brief at 19-23.

⁵⁹ Eckhardt, Ex. 30T at 17:7-16.

⁶⁰ Eckhardt, Ex. 30T at 26:18 to 27:2; Fox, Tr. 260:20-23.

⁶¹ Fox, Ex. 120T at 22:5-6.

⁶² Fox, Tr. 268:8 to 269:7; Tr. 309:3-8.

⁶³ Eckhardt, Ex. 30T at 28:6-7; Lahmann, Ex. 6; Ex. 11; Ex. 12.

⁶⁴ Eckhardt, Ex. 30T at 28:8-9.

individually according to the record in each case and the unique circumstances presented by the subject utility company.⁶⁵ In this case, AWR's unique circumstances include the extensive history of ineffective management. The Commission should disallow Pro Forma Adjustment P-6.

3. Pro Forma Adjustment P-8: Site Assessment

34 AWR argues Pro Forma Adjustment P-8 is appropriate because assisting with the site assessments will cause its employees to work overtime to complete their duties.⁶⁶ Nothing in the record supports AWR's contention. In addition, because the scope of the site assessments is likely to be much less than AWR asserts, it is likely that Company employees will not have to work overtime to accommodate the program.⁶⁷ The Commission should reject Pro Forma Adjustment P-8.

4. Pro Forma Adjustment P-9: Rate Case Expenses

35 AWR argues increased rate case expenses should be allowed in rates due to the complexity and frequency of its appearances before the Commission.⁶⁸ As support, AWR offers Mr. Eckhardt's testimony regarding the seven rate cases and

⁶⁵ See *WUTC v. Pacific Power & Light Company*, Cause No. U-86-02, Second Supplemental Order at 31-32 (September 19, 1986).

⁶⁶ AWR Brief at 26-27.

⁶⁷ See Staff Brief at 24-26.

⁶⁸ AWR Brief at 13-14.

four surcharges filed by AWR in the past eight years.⁶⁹ Notably, not all of AWR's filings resulted in litigation.

36 AWR states in a footnote that the rate case costs requested in Pro Forma Adjustment P-9 do not include costs related to the penalty assessment.⁷⁰ The declarations from Mr. Finnigan and Ms. Parker do not specify that the amounts described therein are limited to litigating the rate case portion of this consolidated docket.⁷¹ Rather, they both state they reviewed their billings to AWR "in this matter," described their billings to date, and estimated future billings.⁷²

37 The Commission will allow rate case costs in rates to the extent supported by the record.⁷³ However, the Commission also recognizes that the reasonable cost of pursuing rate relief is a proper expense for ratemaking purposes.⁷⁴ In this case, Staff's proposal reflects both the expenses supported by the record and the reasonable amount to be included in rates.⁷⁵

5. Pro Forma Adjustment P-4: Pro Forma Debt Adjustment

38 AWR argues that Staff and the Company use different tax rates in calculating Pro Forma Adjustment P-4. However, both parties used the tax rate of 15% for \$0 -

⁶⁹ AWR Brief at 14; Eckhardt, Ex. 30T at 6:12-15.

⁷⁰ AWR Brief at 13, note 70.

⁷¹ Ex. 91; Ex. 92.

⁷² *Id.*

⁷³ Staff Brief at 27; *WUTC v. AWR*, Consolidated 1998 Dockets, Fifth Supplemental Order at 30 (adopted in Sixth Supplemental Order).

⁷⁴ *WUTC v. Pacific Beach Water, Inc.*, Cause No. U-86-57, Third Supplemental Order, Commission Decision and Order on Review at 10 (February 25, 1987).

⁷⁵ Staff Brief at 27-31.

\$50,000. AWR stated it used the 2003 tax rates.⁷⁶ Staff used the 2002 tax rates.⁷⁷

However, the tax rates did not change from 2002 to 2003.

C. Rate Base

39 In this section, the adjustment for gain on the sale of the Birchfield water system,⁷⁸ the adjustment for gain on sale of the View Royal water system,⁷⁹ and the acquisition adjustment⁸⁰ are discussed.

1. Rate Base Adjustment RB4: Birchfield Gain on Sale

40 AWR accuses Staff of “fabricating” the Birchfield gain on sale issue, and that Rate Base Adjustment RB4 is “outrageous.”⁸¹ Staff certainly did not fabricate the issue, and Staff’s adjustment is appropriate in light of AWR’s representations to three state agencies, including the Commission, DOH, and the Department of Ecology, that AWR was the sole owner of Birchfield.⁸²

41 AWR argues it never paid for additional infrastructure added to Birchfield in 1997, 1998, and 1999.⁸³ The fact that Mr. Fox paid for improvements to Birchfield does not translate into separate ownership. Rather, the investment – a capital

⁷⁶ Parker, Tr. 221:9-13.

⁷⁷ Staff, Ex. 203.

⁷⁸ Rate Base Adjustment RB4.

⁷⁹ Rate Base Adjustment RB3.

⁸⁰ Restating Adjustment R-11.

⁸¹ AWR Brief at 5 and 15.

⁸² Staff Brief at 35-37.

⁸³ See AWR Brief at 15-16.

investment in AWR – affects how much of the gain is allocated to Mr. Fox as shareholder of AWR.⁸⁴

42 AWR argues it is “not uncommon for the developer to pay for future expansion and deed over the facilities when needed.”⁸⁵ A developer operates differently than a regulated water company.⁸⁶ In Mr. Fox’s case, he appears to be operating AWR as a developer. Evidence of additional investment exists in the record, but it does not substantiate the amount of investment claimed by Mr. Fox.⁸⁷ Although the Commission admonished AWR regarding its recordkeeping in prior dockets,⁸⁸ AWR had difficulty producing records to quantify the additional investment.⁸⁹

43 Staff’s recommendation is based on far more than “speculation.”⁹⁰ Staff offers a fair recommendation regarding the allocation of gain based on the representations made to state agencies regarding the ownership of Birchfield and on the supplemental evidence provided in Exhibit No. 142.

⁸⁴ Staff Brief at 38-39.

⁸⁵ AWR Brief at 16.

⁸⁶ Eckhardt, Ex. 30T at 13:17 to 14:2.

⁸⁷ Staff Brief at 38. Although amounts associated with labor would have been incurred, the record does not allow calculation of that amount.

⁸⁸ *WUTC v. AWR*, Consolidated 1998 Dockets, Fifth Supplemental Order at 48 (Finding of Fact No. 2).

⁸⁹ Ex. 142 at 1 (“Records that old are difficult to reconstruct.”).

⁹⁰ AWR Brief at 16.

44 AWR argues Mr. Ward “admitted” that Exhibit No. 88 contains the complete list of assets associated with Birchfield.⁹¹ During cross-examination, Mr. Ward accepted AWR’s representations regarding Exhibit No. 88, but Mr. Ward neither created the exhibit, nor possessed actual knowledge of what the exhibit represented.⁹² Exhibit No. 88 contains the same list of assets as found in the sales agreement dated September 5, 2003, which is Exhibit No. 57 in this proceeding. Mr. Fox acknowledged the list of assets in the sales agreement is inaccurate.⁹³ Thus, Exhibit No. 88 is likewise inaccurate.

45 AWR argues it never paid for the wells associated with Birchfield and only one well was necessary to serve the number of AWR customers that used the Birchfield water system.⁹⁴ The record demonstrates that it is difficult to determine every individual asset owned by AWR.⁹⁵ What can be determined is AWR obtained Birchfield when Lewis County Utility Corporation (LCUC) became American Water Resources, and Mr. Fox received stock and a note payable for the water system.⁹⁶ AWR would likely not have designated amounts for each component of each water system it received in the entity change from LCUC to AWR. Thus, it is likely true

⁹¹ *Id.*

⁹² Ward, Tr. 118:10 to 119:14; Tr. 121:21-23; Tr. 122:17-23.

⁹³ Staff Brief at 37-38; Fox, Tr. 291:1-11; Ward, Ex. 77 at 10-12.

⁹⁴ AWR Brief at 16-17.

⁹⁵ Staff Brief at 35; Ward, Tr. at 165:23 to 166:7.

⁹⁶ Staff Brief at 34; Fox, Ex. 120T at 37:2-4; Parker, Ex. 100T at 26:1-2; Tr. 204:22 to 205:6.

that AWR did not specifically pay for the Birchfield wells, or pipes, or pumps; they were all included in the consideration given for the Birchfield water system.

46 Although one well may be sufficient to serve the number of active users, all three wells were serving the system. In the project report submitted to DOH on behalf of AWR, the engineer states:

All three wells are equipped with submersible pumps at present. Wells #1 and #3 jointly serve the existing connections. Well #2 currently serves a single-family home.⁹⁷

The three wells were part of the Birchfield water system, which was owned exclusively by AWR until it was sold to the Lewis County Water and Sewer District No. 5.

47 The record supports Staff's treatment of gain from the sale of Birchfield. The Commission should allocate the gain as Staff recommends.⁹⁸

2. Rate Base Adjustment RB3: View Royal Gain on Sale

48 AWR argues against allocating gain on the sale of View Royal between the shareholder and ratepayers. AWR argues the allocation should not be made because the asset was held for a short amount of time.⁹⁹ AWR does not cite authority for this proposition, and Staff has found none.

⁹⁷ Lahmann, Ex. 17 at 16.

⁹⁸ Staff Brief at 34-39.

⁹⁹ AWR Brief at 17.

49 AWR states the theory behind allocating the gain between ratepayers and shareholders is ratepayers help pay for assets through paying depreciation in rates.¹⁰⁰ However, the allocation of gain rests essentially on equitable considerations.¹⁰¹ Investors do not have an absolute right to the appreciation of value accruing while utility property is devoted to service.¹⁰² Indeed, an investor who has shielded himself from the risk of loss or has already been rewarded for taking the risk does not have a strong claim to the gain.¹⁰³

50 In this case, Mr. Fox shielded himself from risk. AWR purchased View Royal in 1996 or 1997 for a premium.¹⁰⁴ It is likely that the funds used to purchase View Royal were from loans made by Mr. Fox to AWR.¹⁰⁵ By holding debt, Mr. Fox shielded himself from the risk of loss.¹⁰⁶ In addition, AWR's capital structure was almost exclusively debt, placing very little risk on Mr. Fox, and further shielding him from the risk of loss because he had a small amount of equity.

51 The ratepayers bore the burden of the debt. Because the Commission did not allow the premium amount in rate base, AWR carried more debt than rate base for

¹⁰⁰ *Id.* AWR does not cite case authority for this statement.

¹⁰¹ *Democratic Central Committee v. Washington Metropolitan Area Transit Commission*, 485 F.2d 786, 821 (1973), *reh den, cert den*, 415 US 935 (1973).

¹⁰² Staff Brief at 5; *Democratic Central*, 485 F.2d at 800-802.

¹⁰³ Staff Brief at 5; *Democratic Central*, 485 F.2d at 806.

¹⁰⁴ Fox, Tr. 280:18-21.

¹⁰⁵ Fox, Ex. 120T at 14:1-2 and 14:13-21; Parker, Ex. 100T 24:2.

¹⁰⁶ See *WUTC v. AWR*, Consolidated 1998 Dockets, Sixth Supplemental Order at 9 (notes that Mr. Fox, as AWR's principle creditor, will enjoy a favorable position if bankruptcy ensues).

View Royal. However, AWR serviced its debt.¹⁰⁷ Because Mr. Fox was shielded from the risk of loss, his claim to the gain is weak.

52 AWR also argues the gain should not be allocated between ratepayers and the shareholder because it was acting pursuant to Commission direction to reduce debt owed to Mr. Fox.¹⁰⁸ As stated above in section II.A., the Commission did not instruct Mr. Fox to reduce the entire amount of the debt owed to him. Furthermore, the Commission certainly did not instruct Mr. Fox to sell AWR's most profitable water system, creating a cash flow deficit, to pay off the debt owed to him.

53 Moreover, AWR did not sell View Royal in a last minute, desperate attempt to raise money. Instead, Mr. Fox had been negotiating to sell the water system since he purchased it.¹⁰⁹ Mr. Fox was able to negotiate a sales price he deemed acceptable.

54 AWR argues the gain should not be allocated because the sales proceeds were used to retire Mr. Fox's debt, leaving AWR with only bank debt.¹¹⁰ AWR's argument does not support allocating the entire gain from View Royal to Mr. Fox. Retiring Mr. Fox's debt was achieved by allowing Mr. Fox to receive the substantial \$287,265 gain as equity. However, the View Royal proceeds were insufficient to

¹⁰⁷ Ward, Ex. 41T at 9:11-13. It is possible the debt was serviced with funds requested for additional employees because AWR failed to hire and maintain the employees for which additional funds were requested in three prior rate cases, but AWR continued to collect the rates. See Staff Brief at 15.

¹⁰⁸ AWR Brief at 17-20.

¹⁰⁹ Fox, Tr. at 280:11-17.

¹¹⁰ AWR Brief at 20.

pay off the entire amount owed to Mr. Fox. As a result, Mr. Fox had AWR draw on its line of credit to pay the balance.¹¹¹ Because AWR was not paying down its line of credit balance, the bank closed the line of credit to further advances in May 2002.¹¹² The loan was renegotiated and converted into a fixed payment schedule in November 2003.¹¹³ Closing the line of credit resulted in AWR losing access to capital for unknown future operating requirements. Interestingly, Mr. Fox promised the bank in 2000, 2001, and 2002, that AWR would pay down its line of credit with proceeds from asset sales.¹¹⁴

55 AWR states that Staff mischaracterized debt payments to Mr. Fox as “second income” in the *Consolidated 1998 Dockets* because Mr. Fox obtained private loans and re-loaned the money to the Company.¹¹⁵ The *Consolidated 1998 Dockets* is closed and was a fully litigated case. The Commission decided that matter based on the record before it, and re-litigating aspects of that case is not appropriate here. However, Mr. Fox testifies that he charged AWR two percent over the interest he was paying the bank.¹¹⁶ In addition, Mr. Fox continued to charge AWR 12 percent interest after the Commission lowered the amount included in rates to 10.5 percent.¹¹⁷

¹¹¹ Staff Brief at 19-20.

¹¹² Ex. 138 at 2.

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ AWR Brief at 20.

¹¹⁶ Fox, 120T at 15:10-14; Tr. 257:6 to 259:16.

¹¹⁷ Fox, Tr. 260:20-23.

56 AWR argues Staff's alternative recommendation is evidence that Staff's primary recommendation should be rejected.¹¹⁸ This is simply not the case. Staff offers an alternative recommendation because the treatment of gain from View Royal's sale is directly linked to treatment of the acquisition adjustment (Restating Adjustment R-11). Mr. Fox can either receive the balancing that began in the *Consolidated 1998 Dockets* through the allocation of gain on sale from View Royal or through the acquisition adjustment, but not through both.¹¹⁹

57 AWR argues the customers are sharing in the benefit of the sale because AWR's capital structure is "safer."¹²⁰ Although equity rich capital structures are inherently safe, they are as undesirable as equity poor capital structures. While an excessive amount of debt places the Company at risk of failure, an excessive amount of equity causes greater cost of capital costs and unnecessarily higher rates for customers. The goal is a balanced capital structure, and AWR has not achieved such a capital structure.¹²¹

58 AWR's customers have not benefited from the View Royal sale. Mr. Fox sold AWR's best, most profitable system. He did so knowing the Company's cash flow

¹¹⁸ AWR Brief at 21.

¹¹⁹ Staff Brief at 42-45.

¹²⁰ AWR Brief at 21.

¹²¹ AWR states that Staff's position in this case is exactly opposite from that taken in the *Consolidated 1998 Dockets*. AWR Brief at 20. This is not the case. In that case, as in this case, Staff advocated for a balanced capital structure.

would be adversely affected.¹²² Indeed, AWR experienced a \$12,000 to \$13,000 net average monthly revenue reduction as a result of the sale. Mr. Fox discussed with Ms. Parker how the sale would affect AWR. Mr. Fox stated, “We discussed the various ramifications several times. We talked frequently.”¹²³ Thus, not only did AWR’s customers not benefit from the sale, but Mr. Fox knew they would not benefit when he executed the sales agreement.

59 Staff has demonstrated that allocating the gain between the shareholder and ratepayers is appropriate. The Commission should allocate the gain according to Staff’s primary recommendation of using capital structure.

3. Restating Adjustment R-11: Acquisition Adjustment

60 AWR argues that Restating Adjustment R-11 is “predicated on the concept that if the company acquires systems below their historical cost it should be allowed to use the historical cost (adjusted for depreciation) in rates.”¹²⁴ However, this is not the rationale behind the acquisition adjustment. As Ms. Parker testified, AWR is not entitled to automatically include the higher historical cost for systems purchased at a discount.¹²⁵ Rather, allowing the acquisition adjustment in this case recognizes the balancing of premium and discount purchases, which began in the *Consolidated 1998 Dockets*.

¹²² Fox, Tr. 283:3-10.

¹²³ Fox, Tr. 286:1-2.

¹²⁴ AWR Brief at 14.

¹²⁵ Parker, Tr. 203:3-15.

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AWR seems to misapprehend Staff's recommendation by arguing the Commission should not always use the lower acquisition cost or historical cost in rate base.¹²⁶ This is not Staff's recommendation. Staff's recommendation is to allow the acquisition adjustment in this case if the Commission allocates the gain from View Royal according to capital structure. In the alternative, if the Commission allocates the gain according to a symmetry of risk analysis, the balancing is complete because Mr. Fox will receive the benefit of the premium purchase through the gain; and no acquisition adjustment is needed.¹²⁷ In any event, the Commission should not allow double recovery by applying a symmetry of risk analysis to gain on View Royal and accepting the acquisition adjustment.

D. Capital Structure, Rate of Return, Return on Equity, Return on Debt, Customer Count, and Rate Design

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AWR states only that it supports Ms. Parker's recommendation.¹²⁸ Staff maintains the arguments set forth in its Opening Brief at pages 48 through 52, which demonstrate that Staff's recommendations are appropriate.

E. Miscellaneous Issues

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AWR raises arguments regarding AWR's fast expansion, Staff's helpfulness, the ability to establish a reserve account, and AWR's financial viability under Staff's recommendation.

¹²⁶ AWR Brief at 14.

¹²⁷ Staff Brief at 45.

¹²⁸ AWR Brief at 27.

1. Fast Expansion

64 ARW states it received criticism for “growing too fast.”¹²⁹ More accurately, AWR drew criticism not for fast expansion, but expanding more quickly than its ability to manage the acquired water systems, as evidenced by DOH penalty assessments and customer complaints.¹³⁰

2. Staff’s Helpfulness

65 AWR argues Staff is not “helpful.”¹³¹ Staff has spent a significant amount of time working with AWR on cases and other issues.¹³² In formal cases, Staff has advocated positions supportive to AWR¹³³ as well as positions opposing AWR. Staff has not refused to discuss matters with AWR.¹³⁴ It is common for a utility to view Staff as “helpful” if Staff’s advice or position supports what the utility intends to do.¹³⁵ On the other hand, it is common for a utility to view Staff as “critical” if Staff’s advice or position are contrary to what the utility intends to do.¹³⁶

¹²⁹ AWR Brief at 2.

¹³⁰ Eckhardt, Ex. 30T at 9:6 to 12:6; Lahmann, Ex. 1T at 12:9-18.

¹³¹ AWR Brief at 7 (note 37), 24, and 29.

¹³² Eckhardt, Ex. 30T at 42:10-11.

¹³³ For example, Staff advocated – as did AWR – using end of year numbers for AWR’s rate base and customer count, rather than the traditional beginning year/end of year averaging, in the *Consolidated 1998 Dockets*. Also, although Staff included amounts for water systems with no customers in AWR’s rate base, the Commission excluded such amounts. *WUTC v. AWR*, Consolidated 1998 Dockets, Fifth Supplemental Order at 8 and 18.

¹³⁴ See Eckhardt, Ex. 30T at 37:11.

¹³⁵ Eckhardt, Ex. 30T at 40:13-14.

¹³⁶ Eckhardt, Ex. 30T at 40:14-15.

3. Reserve Account, RCW 80.28.022

66 AWR argues Staff's interpretation of RCW 80.28.022 is too strict.¹³⁷ AWR argues most other types of water companies are able to establish reserve accounts. The other types of water companies AWR illustrated during cross examination are public utility districts, water districts, and mutuals. Those water companies are able to levy a tax. Privately owned, regulated water companies do not have taxing authority.¹³⁸

67 RCW 80.28.022 and the establishment of a reserve account are not at issue in this case. AWR is not requesting that one be established. RCW 80.28.022 allows the Commission to provide for funding of a reserve account for specific purposes set forth in statute. The purposes set forth in statute are:

[For] the purpose of making capital improvements approved by [DOH] as part of a long-range plan, or required by [DOH] to assure compliance with federal or state drinking water regulations, or to perform construction or maintenance required by [Ecology] to secure safety to life and property under RCW 43.21A.064(2).¹³⁹

RCW 80.28.022 does not allow the Commission to provide a regulated water company with a reserve account to fund future, unknown expenses or future, unknown capital expenditures.

¹³⁷ AWR Brief at 7-8.

¹³⁸ Lahmann, Tr. 72:10-25.

¹³⁹ RCW 80.28.022; See *WUTC v. Alderton-McMillin Water Supply, Inc.*, Docket No. UW-910563/UW-911474 (consolidated), First Supplemental Order Rejecting Surcharge and Securities Filing (April 10, 1992).

68 AWR argues there are only two ways to be able to respond to emergency situations without a surcharge: (1) for owners to have extra cash and (2) for companies to have a reserve.¹⁴⁰ AWR fails to acknowledge a third method frequently used by water companies: a line of credit. AWR had a line of credit until relatively recently.¹⁴¹

69 A line of credit provides a company with working capital.¹⁴² A company is expected to revolve the line of credit. AWR failed to reduce the principal, but rather drew the maximum amount – in part to pay off debt owed to Mr. Fox.¹⁴³ In essence, AWR treated its line of credit as a standard loan. The loss of the line of credit is harmful to AWR and its customers because AWR no longer has access to revolving working capital. The loss of the line of credit resulted from Mr. Fox’s poor management of AWR.

4. Financial Viability

70 AWR argues it is not financially viable, and will not be financially viable under Staff’s proposal.¹⁴⁴ Essentially, AWR argues it will not be financially viable unless it receives more money.

71 Financial viability is a DOH concept, defined as “the capability of a water system to obtain sufficient funds to construct, operate, maintain, and manage a

¹⁴⁰ AWR Brief at 8.

¹⁴¹ AWR’s line of credit was converted to a regular loan in November 2003. Ex. 138 at 2.

¹⁴² Ex. 138 at 5.

¹⁴³ Ex. 138 at 5; Staff Brief at 19-20.

¹⁴⁴ AWR Brief at 8-9.

public water system, on a continuing basis, in full compliance with federal, state, and local requirements.”¹⁴⁵ Capital is required for construction, and sufficient revenue is required to operate, maintain, and manage the water system.

72 Staff’s proposed rates meet the financial viability test. Staff has proposed rates for AWR that are fair, just, reasonable, and sufficient. The proposed rates will generate sufficient revenue to recover reasonable, prudently incurred expenses and provide AWR an opportunity to earn a reasonable return. In short, the proposed rates will generate sufficient revenue for AWR to “operate, maintain, and manage” its water systems.

73 Rates are not intended to provide capital for future, unknown capital investment. Although rates provide the Company with a source of cash that it can use to invest in capital projects through depreciation expense and return, raising capital is generally the responsibility of owners and management, not ratepayers. Thus, capital required for future construction is not generally a topic for analysis in rate cases before the Commission.¹⁴⁶

74 That financial viability was not specifically analyzed in this case is neither unusual, nor notable. In *Alderton-McMillin*, the Commission rejected a water company’s request for a surcharge even though the ruling might cause the

¹⁴⁵ WAC 246-290-010 (Public Water Supplies, Definitions).

¹⁴⁶ In appropriate circumstances, the Commission may approve a surcharge to be paid by ratepayers. Surcharge funds are treated as contribution in aid or construction.

company hardship with DOH.¹⁴⁷ The Commission noted that if the company intended to proceed with its plans, it would have to “look elsewhere” for funding.¹⁴⁸

75 The Commission regulates in the public interest. The public interest, not DOH standards, governs whether rates are fair, just, reasonable, and sufficient.

F. Rate Case Conclusion

76 AWR has failed to establish that a rate increase is needed. Staff has met its burden of proof by demonstrating the rates proposed by Staff are fair, just, reasonable, and sufficient.

III. PENALTY ASSESSMENT

77 AWR offers four reasons why the Commission should mitigate the penalties against Mr. Fox.¹⁴⁹ The first reason is the tax liability on the sale of View Royal arose unexpectedly as a result of Ms. Parker’s good faith error. The second reason is a tax liability arose on the Docket 010961 Account funds because Staff refused to help AWR. The third reason is the penalty was miscalculated. The fourth reason is the Commission should consider the totality of the circumstances and exercise its discretion to mitigate the penalty. None of the reasons Mr. Fox offers are sufficient to mitigate the penalty assessment.

¹⁴⁷ See *WUTC v. Alderton-McMillin Water Supply, Inc.*, Docket No. UW-910563/UW-911474 (consolidated), First Supplemental Order at 6.

¹⁴⁸ *Id.*

¹⁴⁹ AWR Brief at 28-29.

A. Tax Liability for View Royal was Foreseeable

78 Although Ms. Parker advised Mr. Fox that AWR would probably not incur a tax liability on the View Royal sale, there was a distinct possibility of a tax liability.¹⁵⁰ Ms. Parker based her advice on estimates of rate base calculated by memory.¹⁵¹ Ms. Parker determined that the net operating loss carried forward (based on the 2000 tax return before it was amended) was \$262,467.¹⁵² Ms. Parker estimated that View Royal had approximately \$250,000 in rate base, which would render the gain to be approximately \$250,000 on a \$500,000 sale.¹⁵³ The sale price was \$500,000, but the net gain on sale was \$287,265.¹⁵⁴ Thus, even based on Ms. Parker's estimates, AWR would still have experienced a tax liability. In addition, the 2000 tax return had to be amended, which resulted in the net operating loss being reduced.¹⁵⁵

79 Spending the entire amount of the proceeds was imprudent, regardless of the purpose.¹⁵⁶ Prudence requires a reasonable decision process and a reasonable decision, although not necessarily a "correct" decision.¹⁵⁷ The test for prudence is what would a reasonable board of directors and company management have

¹⁵⁰ Staff Brief at 20-21.

¹⁵¹ Ex. 112.

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ Staff Brief at 39.

¹⁵⁵ Parker, Tr. 208:2 to 209:3.

¹⁵⁶ Staff Brief at 56.

¹⁵⁷ *WUTC v. Cascade Natural Gas Corp.*, Docket No. UG-941408, Third Supplemental Order, Commission Decision and Order at 3, note 4 (October 31, 1995) (citations omitted).

decided given what they knew or reasonably should have known to be true at the time they made the decision.¹⁵⁸ In this case, the decision to sell View Royal was imprudent because Mr. Fox knew at the time of his decision the adverse effects the sale would have on AWR and its customers. In addition, the decision to apply the entire proceeds to reducing debt owed to Mr. Fox was imprudent because the sales proceeds should have been retained to offset the cash flow deficit caused by the sale.¹⁵⁹ Spending the entire amount of the proceeds was imprudent because Mr. Fox's interpretation of the Commission's order in the Consolidated 1998 Dockets was unreasonable.

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Mr. Fox ultimately made the decision, not Ms. Parker, to apply the entire amount of the proceeds to reducing debt owed to him. If he had acted prudently, the money would have been available when the tax liability arose. Instead, Mr. Fox personally retained the sales proceeds and made a conscious decision to violate the Commission's Order Approving Settlement Agreement. The tax liability for gain on View Royal is not a mitigating factor justifying eliminating or reducing the penalty against Mr. Fox.

¹⁵⁸ *Id.* at 3.

¹⁵⁹ Staff Brief at 21.

B. Tax liability for Docket 010961 Account Funds

81 Assuming that AWR owes a tax liability,¹⁶⁰ the money accumulated in the Docket 010961 Account as a direct result of Mr. Fox's imprudent decision to sell View Royal. Staff did not cause, directly or indirectly, the tax liability. Nor did Staff cause Mr. Fox to allow AWR to use the Docket 010961 Account funds for unauthorized purposes. Mr. Fox's attempt to blame Staff for his decisions is fallible and fails to mitigate the penalty assessment.

C. The Penalty Was Properly Calculated

82 The penalty was not miscalculated, as Mr. Fox argues. Mr. Fox uses as an example the \$400 penalty assessed for failing to make the June 2002 deposit. The calculation of the penalty took into consideration that the deposit for June 2002 was due in July 2002. The penalty began in July, continued during August and September, and ended in October. The penalty was assessed for each month AWR failed to make a deposit. In this example, the number of months is four: July, August, September, and October. Each of the failure to deposit penalties is properly calculated in this manner.¹⁶¹

¹⁶⁰ Staff maintains that the tax liability on the Docket 010961 Account funds can be avoided. Staff Brief at 9-11.

¹⁶¹ See *Penalty Assessment Against Virgil R. Fox, President, American Water Resources, Inc.*, Docket No. UW-031596, Penalty Assessment Order.

D. The Totality of the Circumstances Demonstrate Mr. Fox's Application for Mitigation Should be Denied

83 Staff agrees the Commission should consider the totality of the circumstances in evaluating Mr. Fox's application for mitigation. The totality of the circumstances demonstrate the Commission should deny mitigation and order Mr. Fox to pay the full amount of the penalty.

84 Mr. Fox represented to the Commission that AWR needed two additional employees in Docket No. UW-010961. While he was negotiating the issues in Docket No. UW-010961, Mr. Fox was also negotiating to sell View Royal.¹⁶² Less than one month after receiving approval to collect an additional \$3.47 and to set aside \$4.40 from each customer bill for the additional employees, Mr. Fox sold View Royal, AWR's largest and most profitable water system, making the additional employees unnecessary. Thus, AWR no longer needed the set aside funds. However, Mr. Fox allowed AWR to collect \$125,113 from its customers over approximately 21 months. Mr. Fox allowed AWR to fail to deposit funds as required although the funds were being collected.

85 Mr. Fox further allowed AWR to use the Docket 010961 Account funds for unauthorized purposes. Those purposes were to pay taxes on gain from the View Royal sale and taxes on Docket 010961 Account funds. Not only were the Docket

¹⁶² Staff Brief at 8; Fox, Tr. 282:4-5 and 282:15-19.

010961 Account funds never intended to pay taxes, but both taxes arose due to Mr. Fox's imprudent decisions.

86 The totality of the circumstances indicates that mitigation is not appropriate. Mr. Fox should be required to pay the entire amount of the penalty within 15 days of entry of the final order in this case.

IV. CONCLUSION

87 Staff's recommendation that the Commission order AWR to lower its rates by \$100,555 annually is the result of properly applying regulatory principles and is supported by the record. In addition, the Commission should deny Mr. Fox's application for mitigation and order him to pay the full penalty amount.

DATED this 9th day of July 2004.

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