UW-070944
Attachment B
Company Response to Customer Comments

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

PO Box 47250
Olympia, WA 98504-7250

John Cupp
Consumer Program Specialist
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To: Jim Ward

Date: August 20, 2007

Re: Rosario Utilities UW-070944

Jim,

Here is a copy of Rosario Utilities' two-page response to questions raised at the June 14 meeting by Hugh Hendrick.

Thank you,

John

Proposed draft of testimony before the WUTC
Prepared by H Hendrick May 20, 2007

MAY 23, 2007 a.m.

There are four egregious inequities favoring the Resort and holders of "banked" water permits (the Resort and residents) which cause unfair higher costs for residential users which need to be rectified:

1. The use of arbitrary, unmeasured ERU's for determining the number of base rates to be paid by the Resort has not been changed to reflect actual water usage from the water metering ordered by the Commission. The use of base rates by the Resort during the 8 low tourist-volume months is needed to provide minimum water revenues to cover monthly water plant fixed costs related to providing peak months water volumes.

The Commission ordered Rosario at the last hearing to install meters to measure and account for their actual water usage. We have been told that six meters were installed for measuring Rosario water usage. Rosario base rates should be based on the peak guest count month of August since the water plant and its fixed costs are sized for servicing the peak guest period. The determinant for the base rate to be paid should reflect all Resort water usages. These usages include the restaurants, the Spa and its showers, the indoor and outdoor pools, hot tub, sauna, the marina, and and other water uses.

We recommend that for accounting simplicity, accuracy, and avoidance of an unfair shifting of Rosario-related costs to residential users, that the annualized fixed costs of the plant be

a) apportioned between Rosario and the residents on the basis of the meter readings of all water used by Rosario, and
b) be paid as a single monthly billing rather than on the basis of Health Department ERU's which are not regularly adjusted to reflect total Resort water usage.

2. The proposed rate increases need to be granted only temporary temporary until either the first demolition permits are issued or 25% of Resort-owned accommodations are closed to allow demolition of existing Rosario guest accomodations and their replacement with of a 146 unit private residence village.

The Resort and the wholly-owned Water Utility company are in advanced stages of being sold. The tentatively approved Master Plan for the Resort lands call for 455,000 square feet of new construction which includes 146 privately-owned fractional unit residences with a total of about 429 bedrooms, These 1000 to 2000 sqft units will include kitchen, multiple bathrooms and laundry facilities.

Accordingly at such time, as the Resort is closed or reduces guest operations, the Resort needs to be charged for their normal share of fixed costs since closing the Resort is a temporary business decision to increase profits from an expansion. The new Resort should pay equivalent charges during the construction period so that the uncovered fixed costs of the water plant do not result in a huge loss which must be made up by the residential users.

We bring this before the Commission at this time since we understand that as Customers we lack standing to obtain a hearing when the existing resort ceases full time operation but the fixed costs of the water plant continue. By making the proposed rate increase temporary, the rates would have to be revised. Alternatively, the commission could order that fixed costs of the water plant continue to be paid until the new Resort Community has been constructed and the residences fully sold.

3. The folding of the balance of Rosario's share of the outstanding loan (from the owners of Rosario to their water company subsidiary) for the Hydroxol Treatment Plant into the water rates is an unacceptable precedent since Rosario is about to be redeveloped as a private housing resort by a new owner and will require expansion of the water plant and resort distribution system. There is no basis for requiring residents to subsidize the new residential community paying for any plant expansion for the larger new resort in their water rates.

At the previous rate hearing, the RPOA asked that the monthly plant loan payment be raised since it was clear there would be both a shortfall and increased costs of interest on the loan (staff said no).

Now the proposed Rosario Utilities solution is to increase the costs of the loan to residential users by requiring us to help the Resort pay off its costs of the Hydroxol Plant when the Resort is closed for reconstruction as a private residence resort village. Including plant capital cost in the water rates would mean that residential users will be saddled with underwriting the expansion of the water plant to service 455,000 square feet of new construction which includes 146 units with a total of about 429 bedrooms, kitchen, multiple bathrooms and laundry facilities.

We therefore must insist that beginning with this rate increase filing, all plant capital costs be segregated between those applicable to the resort and those applicable to residential service. Furthermore, expansion costs for the benefit of new residential users must be paid for by those users and not by current users who have already paid or are paying for plant expansion.

San Juan County has approved, subject to an enabling ordinance, redevelopment of the Resort as a fractional shares privately owned housing development. The current owners of Rosario are in the process of selling the resort property to a developer.

4. Both the monthly Base Rate and the "Ready to Serve" rates are inequitable to residential water users by failing to recover fixed costs related to inactive account and unconnected permit holder claims on plant production. Each permit represents a claim on guaranteed plant water delivery capabilities and storage capacities. The insufficiency of proposed rates for "ready to serve" permit holders means that plant costs must be covered by water users.

Under then principals of standard cost accounting, all permit holders should be required to pay the full costs of "standby" service. For water users and "Ready to Serve" permit holders alike, that means a prorata apportionment of plant annualized fixed costs. Under IRS recognized standard cost account procedures, only truly variable costs would not be charged to permit holders who do not use water in a particular period.

The RPOA can understand that in past times the water utility and Rosario Resort could present themselves as unsophisticated and unable to use off-the shelf cost accounting software. But the coming sale by the $10 billion partnership owners of the Resort for converting the Resort o be a private residence resort community demonstrates that somewhere within the organization, the accountants and lawyers who repositioned Rosario from an unprofitable resort to a private resort village surely have the capability to assist Rosario Utilities with appropriate computer accounting software and to fairly apportion ale the fixed and variable costs in appropriate percentages.

In summary unless the Commission acts on these four procedural requests, the residents will surely be victims of unfair rates as the resort demolition and private housing development goes forward.

Suggested rate issues form the 23 item list to be presented to the Commission
Prepared by hhendrick May 20, 2007

1. A $200,000 loan has funded piping upgrading - how much of this loan is being used to prepare for the increased water deliveries the future resort is expected to need? If piping is dual use (the Resort and the Residents), is the relative cost share determined by the volumes of water provided? Is there sufficient audit documentation to support charges to residents for the costs of the piping and the loan payoff share that will be the responsibility of the residents? Are the accounting procedures in place to allocate the costs of pipe replacement between the resort and residential users?

2. What is the base rate intended to accomplish. How was the proposed base rate determined? What is the relationship of the base rate to plant fixed and variable costs. If the base rate is to guarantee revenue from inactive or very low volume accounts, does the base rate fully cover plant and distribution costs related to water delivery to the account.?

3. Conservation rates are intended to discourage avoidable water uses and care to prevent monitor for water leaks and other water wasteage. For the typical homeowner, less than 100 gallons per day in the lowest rate category is rather limiting for for a multiperson household. Wouldn't 125 gallons a day be more appropriate? At the high end should the penalty rate for over 7500 gallons a month be high enough to discourage unnecessary water use , say an addition .01 to .015?

4. Since the same employees work for the water plant and the sewer plant, how are payroll costs allocated? Is the allocation reliable. What about common materials and tools, etc.

Rosario Utilities, L.L.C.
1400 Rosario Road, Eastsound, Washington 98245 (360) 376-2700 Fax (360) 376-2289

July 13, 2007

Mr. Hugh Hendrick
400 Cascade Way
Eastsound, WA 98245

Dear Mr. Hendrick;

The company did want to respond to your letters presented the the utility and the UTC at the June 14th open meeting, I'm just sorry it's taken so long. Your two main concerns are below with our responses following:

(1) The use of an estimated ERU needs to be eliminated from the proposed Schedule No. #3 Metered Rate Service, Commercial Tariff.

ERUs are not estimated by the utility. The company's Water System Plan has ERUs defined by consulting engineers, basedon actual metered water usage. The plan is approved by the WSDOH. Actual metered usage data is also provided to the UTC staff so an analysis can be completed as to the fairness of the revenue versus consumption for each customer class.

Resort water rates are based on metered usage, in addition to the base rate, at the same rate per gallon that residents pay. The base rate was obtained by the average usage of water by the resort in a year in comparison to a residential unit. The percentage amount of water used by the resort each year reflects almost the same percentage of the revenue, just as the residents' water usage reflects their percentage of revenue.

When the resort redevelops in coming years, water usage will be lower than it is now during construction, however the resort will still be paying the base rate and usage fees for what water is consumed. Additional connections purchased for the new development will be charged ready-to-serve fees, until water use begins.

(2) The proposed tariff does not conform to most common water plant billing practices.

Ready to serve charges and service base rate fees, plus metered water usage are standard practices for water companies. Ready to serve fees were recommended to the utility by the UTC. Unregulated water systems, including the Eastsound Water Users Assn, also charge ready to serve fees or inactive account fees, which are lower than the base fee for a residential customer. It is our understanding that if large municipal water systems do not charge ready to serve fees, it is because residents do not purchase water connections years before they intend to use them.

Part-time residential customers pay the base rate all year round, and do so to keep full-time residents from paying more than their share of the total cost. Yes, ready to serve customers do represent a claim on the total plant, but ready to serve fees are lower than actual water users, because there is no water usage and therefore fewer chemicals purchased, less electricity and operational treatment costs, also no meter to read.

I hope that this helps to clarify the utility's current rate application. Also, please feel free to contact me if you have any questions.

Sincerely yours,

ROSARIO UTILITIES, LLC

Chris Vierthaler
Chris Vierthaler
General Manager

cc: John Cupp, UTC
Jim Ward, UTC

WASHINGTON
UTC
UTILITIES AND TRANSPORTATION COMMISSION

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To: Jim Ward

Date: August 20, 2007

Re: Rosario Utilities UW-070944

Jim,

Attached is a copy of the list of questions presented by the Rosario Property Owners Association on May 23, and Mike Ireland's response to same.

Documents are four pages each.

John

[redacted]

May 23rd, 2007

To the WUTC Commissioners and Staff:

Greetings! We are here to represent Rosario homeowners, who are greatly troubled about the proposed water rate increase by the soon to be sold Rosario Utilities. Contrary to some perceptions that we are a community of the wealthy & retired where rate increases do not matter, we want you to know that while there are some for whom money is not an issue (as there are in most communities), we have many homeowners who are retired on fixed income with small income increases, others who are retired but still have to work part-time to make ends meet; others who still work full-time, and still others who have to work 2 or 3 jobs to pay the bills.

The average water fee on the Rosario side the island for 4000 gallons a month usage (the amount illustrated in the new rate proposal) is about $35. The new rate proposal would jump our current rate of just under $40 to just over $65/month. This represents a 63% increase in the base rate—which includes no water-- and a 136% increase in the first tier of water usage. The ready to serve increase is 100%.

The Board of the Rosario Property Owners Association (RPOA) would like to thank Jim Ward, Lynda Johnson, and John Cupp for their time and interest in our arguments for some mitigation of the proposed rate increase by Rosario Utilities.

We as the Rosario Property Owners Association Board (RPOA)have a lot of questions we are trying to resolve, and have appreciated the opportunity to discuss some of them on the phone over the last few days with John, Jim and Lynda. Other questions and thoughts that follow are those presented by members of the community to this Board. As we were told that you will have some oversight of the sale of Rosario Utilities to Washington Water Service, some of the comments are forward-looking and pertain to the sale, because we believe they are issues of fairness. We do not question the fact that every business, including utilities, need to make a profit. We are just looking for it to be based on solid assumptions and numbers, and for the amount of the increase to be fair.

The relationship between Rosario Utilities and the community has not been an untroubled one, and there is quite a lot of residual distrust in the community that could be resolved with clear answers to the questions we are asking. This would be a great benefit to all, including the proposed new owner, but may require more time for resolution than is currently allotted.

We need to say upfront that it is our conviction that it is inappropriate for a regulated utility to be asking for a rate increase when they are under contract to be sold as soon as the rate increase takes effect, and will, in many ways ~~will~~ become a new company. It makes complete sense and would result in a trusting relationship between owner and consumer if the new company would purchase the utility at an appropriate price in relation to what RU is valued today, then implement their changes and request an increase based upon their own performance. This statement is being made based upon the belief that Washington Water Service (WWS) will be able to manage the system more efficiently than is currently done, as they themselves proposed at the April 2nd meeting. The resulting basis for a rate increase could truly be verified and could very well be lower than the proposed increase of a company who clearly has had problems in this area.

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If the rate increase does go forward, our goal is to feel confident that each % of increase that is granted to the various areas on the schedule is justified by solid numbers, and that the amount being charged to residential customers is fair in comparison with what the Resort pays, and is based upon the impact each has on the system. We are confident that your audit will be thorough and your decision impartial and fair.

The following are our questions/concerns:

1. When RU separated their water rights from the land last year, and transferred them to their affiliate called Orcas Water Holdings, was this a transfer of regulated assets to an un-regulated affiliate? Also, will these rights to water now be sold to the highest bidders, to whom the Utility will have to go whenever additional water is needed? Is there any regulatory oversight of sales of water rights like this, where they are no longer tied to the land in the community they supply? Is there any oversight on the price consumers have to be when water is turned into a speculative commodity?

2. The 1mm, 7 year loan to build the plant in 2000 was at 9.25% interest. Beginning in 2001, interest rates dropped significantly. Why was this interest rate not renegotiated? We were told it was because the owners would not allow it to be renegotiated. The parent company, Olympus Partners, who held the note, most certainly profited (while they appeared to be losing money by other measures) by receiving the 9.25% as well as reducing their taxable profits for RU by charging this rate. While this is certainly legal, how can it be described as ethical or fair-minded to the consumer of this monopoly when the appropriately reduced interest rate recalculated would have resulted in significant consumer benefits in regard to the loan payoff balance & timetable & interest paid?

- The UTC was told during the 2002 rate request that RU would fall short on the loan due to the Health Department capping the maximum number of connections at 127 rather than 184 as originally calculated. But the UTC's decision was to deal with the issue later. The result of that decision was that this January, when the surcharge instituted to pay off the loan ended, the loan was not completely paid off as the consumers were assured it would be. Many ratepayers think the loan balance is zero because the surcharge has ended, and no mention has been made otherwise.. Those who know are irate that the issue wasn't dealt with when it was discovered. And we ratepayers are left with a balance in excess of $275,000—which is more than 25% of the original loan balance.

- We have been unable to obtain any information as to how the balance of this loan is being treated. Is it in this new rate structure or in the sale? Is it in both? How can we find out?

- We are told that no interest is accruing on that balance due? Is this true?

- There are two lines of credit—each in excess of $200K—that now have draws on them. How much is owed, and how are they being treated in the rate proposal and the sale?

3. Historically, because the Resort and the Utility have been under the same ownership, we have been told that there has been commingling of costs between the two, and between

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residential and commercial water and sewer customers. How can we be assured that these costs are now separated and allocated to the correct party? We want to be certain that residential users are not paying for usage or infrastructure that the Resort should be paying for.

For example, the same employees work for the water plant and the sewer plant. How are payroll costs allocated so water customers aren't paying for sewer employee expenses? Is there a system in place to determine this? What about for common materials, tools, etc.?

- One of the $200,000 lines of credit is funding installation of a larger that was intended to be done when the plant was built, but there wasn't enough money. Since the current piping is serving existing needs well, why is the larger piping being installed? Is it to prepare for the new demand that will come with the Resort build-out? If it is partially to replace old pipe and partially to prepare for the anticipated new demand from the Resort, how are the charges for this loan being allocated between residential and commercial users? Are there accounting systems in place to do this? We look to you for determining if there is sufficient audit documentation?

- Looking forward, we ask Rosario Utilities & Washington Water not to place all improvements into a single pooled account. The water treatment plant will have to be greatly expanded to service the new Resort, and the water distribution system for the Resort must be rebuilt. Unless separate records and billings are setup for a Resort capital account and for a Residential Capital account, we residents will subsidize the construction of the water system for the resort, which is inappropriate & unfair.

4. We question whether the way the ERU (equivalent residential unit) has been defined is accurate--whether its unit of measure provides a true equivalency for the residential usage it is measuring. Now that the Resort has been metered for a few years, we request that ERU definition be reconfirmed. Whether or not the ERU definition is correct determines how many base rates the Resort is paying for. Fairness in this matter is extremely important to our homeowners. We understand that a few years ago, the Resort realized it was using more water than previously thought, and they added more ERU's to their billing. We appreciate this voluntary act of goodwill, but greater clarity on this subject would be welcomed and seems necessary.

5. Regarding the rate schedule. Promoting conservation of water is a state mandate. But this new rate schedule does not promote conservation- if it did, it would have significantly higher per gallon charges for uses of water above the lowest tier. The new rate schedule not only doesn't make increased water usage significantly more expensive, it actually reduces the differential between the top 2 tiers of usage. Can this be revisited?

6. What is the base rate intended to accomplish? How was the proposed base rate determined? What is the relationship of the base rate to fixed and variable plant costs? If the base rate is spread facility costs evenly, it must guarantee revenue from inactive or very low volume accounts, Does the base rate fully cover plant and distribution costs?

7. Why does the Resort, which requires the system to have greater capacity than would otherwise be needed for residential customers (because of its peak summer demand & for

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fire flow) pay the same base rate as a residential customer? Rosario Resort base rates should be based on the peak guest count month of August since the water plant and its fixed costs are sized for servicing the peak guest period.

8. If and when the Resort temporarily shuts down partially or fully for demolition and construction next year, is the mechanism in place so that they continue to pay their share of fixed costs?

9. We have been told that the water rights that will be or have been (have they been?) transferred to RU will only cover existing customers—both residential & commercial, and ready-to-serve customers. Will there be any extras? Or will any additional connections have to be obtained from whomever owns them at the time, at whatever cost the owner sets?

10. Rosario Resort recently sold excess water "memberships" for $8500. What exactly does that buy? Why does the resort sell the memberships at a different price than the utility company? Please explain the membership fee buys, and how it is calculated

11. Are the books of Rosario Utilities audited? Can customers obtain the results of audits?

12. There were apparently significant cost over-runs from the building of the plant. How much did they total? Why did they occur, and where and how are they being accounted for in the new rate proposal and in the sale?

Thank you for listening to our concerns. We will continue to search for answers to our questions, and look forward to your audit process and any answers to our questions that it might bring forth.

We thank you for your attention in reviewing these matters and trust in your mission to protect the consumer through "fair rates, and compliance with service quality and equitable business practice standards".

Respectfully,

For: The Rosario Property Owners Association

By: The RPOA Board

Jobin Suthergreen, President
Deborah Carruth
Carol Marcin
Eileen Pyka
Carl Yurdin

1. The water rights that were transferred to Orcas Water Holdings (an affiliate of Oly Rose, LLC) were never owned by Rosario Utilities and the transfer had no impact on existing customers of Rosario Utilities. The water rights in question were originally acquired by Robert Moran, thus they have always belonged to the owner of the Resort property, currently Oly Rose. A portion of those rights has been devoted to domestic purposes to supply the customers of the Rosario water system, including the RPOA and Rosario Resort. <u>All of the water rights used or committed to existing customers of Rosario Water System, including those with "ready to serve" connections, were transferred by Orcas Water Holdings to Rosario Utilities without charge.</u> Oly Rose and its affiliate company Orcas Water Holdings have decided to market the balance of these water rights to benefit others with domestic water needs of municipal purpose on Orcas Island. This process has involved substantial investments by Oly Rose. Because these excess water rights are not the property of the Rosario Water System, they can be transferred without Commission approval. Orcas Water Holdings is reserving sufficient water rights for future residential connections to Rosario Water System. Connection charges to the water system are subject to Commission approval.

2. Financial institutions consider Rosario Utilities to be a small utility. Small utilities have difficulty in securing bank financing at lower rates. Most financial institutions do not understand water utilities and the rate making process so they are not eager to loan money to them. Therefore, due to this and higher loan fees they have a higher cost to secure funding.

    - The connection fee and surcharge was calculated and approved by the WUTC more than a year before the plant was completed and based on the best knowledge available at that time. Subsequent decisions by the DOH reduced the number of connections from 184 to 127, thus reducing the revenue to recover the cost of the plant. The surcharge was not included in the 2002 rate case. Normally 100% of capital improvement costs are NOT recovered through surcharges and facility charges. Investor owned utilities are encouraged to invest into their water systems, thus having an investment of 27% of a capital improvement is not out of the normal

    - The balance is being treated as capital and recovered as part of the rate of return and depreciation.

    - An interest expense is calculated as part of the cost of money, which is used in calculating the rate of return. Interest will be calculated, but at a lower rate. The surcharge has expired, but the debt hasn't.

    - Approximately $48,000 has been drawn on the two state revolving fund loans. The draws will be treated as an investment of Washington Water for the water system purchase. The plant was included and capitalized.

3. Ever since the utility was formed as a separate company in 1996, the only cost involved is that of Rosario Utilities, which will be verified through the UTC audit. The labor costs are split 65% water and 35% waste water and based on historical data.

    - The upgraded water treatment plant will not completely satisfy the resort build out. The resort will be responsible for additional improvements to treatment, production and distribution upgrades. The loan to upgrade piping is to bring the water plant up to its design capacity and correct pressure problems. It is considered a continuation of the original upgrade which affects all existing customers. Charges will be based per ERU.

    - The larger lines will allow for some growth, but will primarily allow for the connection of those customers currently charged a stand-by charge. The cost of these improvements will be capitalized. However, the rate impact should be minimal as they will allow for additional customers to share in the total revenue requirement. It may be beneficial to all customers to allocate some portion of the resort's distribution upgrades to all users, say, rather than to install two separate parallel lines, one for the resort and one for residential customers. This must be approved by the WUTC and the resort will pay for the upgrades considered developer's costs.

4. In the 2004 Water System Plan, engineers analyzed resort and residential water use, and the plan was approved by DOH. Using the calculations provided in the plan and approved by DOH, the utility proceeded to charge the resort based on the ERU count in the plan. The resort is currently paying for 118 bases, with water usage in addition. Once completed, the imminent redevelopment of the resort will trigger a new calculation of the resort ERU's.

5. We are trying to encourage water conservation, not punish customers or trying to over earn if usage is higher than expected. Rate structure is a very delicate balance. You need rates that return the authorized rate of return, not more or less. Placing too much into the upper tiers, can disrupt the whole process with wet or dry summers. With a resort, which has very high seasonal usage, having a high commodity charge provides too much of the revenue stream during the summer months, thus making the water system too weak financially during the winter months and susceptible to poor attendance at the resort during down summers.

6. The base rate and ready to serve are intended to recover approximately 60% of the total required revenue to cover operating costs and return on investment.

    The base rate was determined first then the commodity charges utilized to calculate the balance of the needed revenue.

The tiered charges were designed to cover approximately 12-15% of the total revenue and were split in order to achieve a balance and reduce the chances of over or under earning due to seasonal weather conditions.

No, the base rate plus ready to serve cover approximately 88% of the fixed operating costs.

7. The Resort provides its own fire flow system, which is completely separate from Rosario Water System and does not affect the water system's capacity. Based on an equivalent residential user (ERU) the resort pays the same base rate as residential customers. ERU's are based on average yearly consumption. The engineer's analysis of water usage in the water plan shows that peak usage occurs for both the resort and residences. Because retail customers usage is different from wholesale customer usage, and both are different from resort usage, the peaking is blended to come up with system wide capacity requirements.

8. If and when the resort shuts down they would either continue to pay the base metered rate or more depending on what if any water usage is needed during construction.

9. The domestic/municipal use water rights needed to serve existing residential customers of Rosario Utilities (including ready to serve customers) have been transferred to Rosario Utilities without charge by Orcas Water Holdings. The remaining water rights will be held by Orcas Water Holdings and available for sale. Either future customers of Rosario Water System will purchase water rights individually, to be transferred to the water system as Contributed Aid, or Washington Water Service may purchase some of the water rights and recover its investment through facility charges from new customers. Neither option will have a negative impact on current customer rates.

10. Water connections purchased by Rosario Resort in 2001 were planned to be used for the beginning stage of the Master Planned Resort (which was expected to be approved years ago). Recently, with the master plan yet to be approved, the resort was approached by members of the RPOA and asked to sell some of its connections to residents as a gesture of good will, and the resort agreed. Rosario Resort did not sell "memberships" nor are memberships in the water system available. Rosario Resort sold these connections for $8500 in private transactions not regulated by the WUTC. The price is less than the $10,000 connection fees of several local water systems, and the resort also paid the surcharges for each connection.

11. Yes, as part of the rate case, UTC will audit the books of Rosario Utilities. The results of the audit will be part of the UTC recommendations. However, staff work papers are not available until after the rate case resolution.

12. Cost over runs on the water treatment plant totaled $216,818 and are now considered part of the total plant value. By court order, the company was given very little time by the WA State Dept. of Health to build the new plant. The Health Dept. also waived normal testing of the treatment processes prior to construction, with these

tests and monitoring done at completion instead. Unfortunately, the original treatment process proved to be cost prohibitive, so many modifications occurred during construction.

<u>Note;</u> an error was found in the Rosario Resort Tab of the 04-17-07 ROSARIO Metered Rate Worksheet Old vs. New rates. The total of Column D in cell D44 had a bad formula. It totaled column E and not column D. The new total for Cell D44 should be 63,688 gallons per ERU.

Agenda Date: June 6, 2007
Item Number: A4

Docket: **UW-070944**
Company Name: Rosario Utilities, LLC

Staff: Jim Ward, Regulatory Analyst
John Cupp, Regulatory Analyst
Lynda Johnson, Consumer Program Specialist

Recommendation

Take no action on this filing at this time.

Discussion

Today's presentation is to allow customers and other parties to make comments to the commission. No action is required by the commission. Staff will make its recommendation to the commission at the open meeting on June 27, 2007.

Background

In December 2006, Rosario Utilities, LLC, (Rosario Utilities or company) and Washington Water Service met with commission staff for discussions. Rosario Utilities was proposing to file for general rates and noted the capital improvement surcharge would be expiring in January 2007. Washington Water Service was also interested in buying Rosario Utilities. Several discussions have occurred over the last several months regarding the rate filing.

On April 2, 2007, Rosario Utilities and Washington Water Service held a public information meeting on Orcas Island. Commission staff participated by conference call from Olympia. The meeting was held to discuss a proposed general rate increase and to introduce personnel from Washington Water Service, who is negotiating to purchase the water company. Rosario Utilities provided backup financial documents to show customers the sources of the need for a rate increase. The rate filing process and sale and transfer process were explained to the customers. Customers asked several questions about the former capital improvement surcharge and capacity of the water treatment system. The meeting was attended by about 60 people.

On May 11, 2007, Rosario Utilities filed for general rates for $148,095 (62 percent) of additional revenue per year. Rosario Utilities serves 508 customers near Eastsound, on Orcas Island in San Juan County. The company made the filing to offset higher operating costs and to capitalize capital improvements completed, but not totally paid by the surcharge, which expired in January 2007. Improvements were needed to meet increasingly stringent water quality standards. Additionally, the company replaced aging plant to improve the reliability of the water system. The rate design will remain with the same usage blocks to help encourage water conservation. The company's last general rate increase was August 2002.

On May 23, 2007, the commission heard this item at its open meeting. Four customers attended and participated in person, and another group participated via the conference bridge line. To date, 38 customers have voiced opposition the company's proposal. The main issue remains the amount the company seeks to increase its rates.

One concern many customers voiced is they want to make sure everyone gets an opportunity to comment. In addition to the May 23, 2007, open meeting and the meeting with customers that immediately followed, and today's meeting, staff will attend a meeting in the company's service area on June 14, 2007, to answer questions and address concerns. Rosario Utilities sent a bill insert in its most recent bills, informing customers of the June 14, 2007, meeting, which Washington Water Service will also attend.

The customers were notified of this increase in a mailing on May 10, 2007. The current and proposed rates are provided below:

Monthly Rate	Current Rate	Proposed Rate
Orcas Highlands & Otter's Lair per ERU		
Bulk Meter Zero Allowance	$25.00	$38.45
Residential & Commercial Customers per ERU		
Base Meter Zero Allowance	$29.75	$43.20
Water Usage for all Customers		
0-3,000 gallons, per gal	$0.0022	NA
3,001-7,500 gallons, per gal	$0.0034	NA
7,501 or more gallons, per gal	$0.0047	NA
0-3,000 gallons, **per 100 gal**	NA	$0.52
3,001-7,500 gallons, **per 100 gal**	NA	$0.55
7,501 or more gallons, **per 100 gal**	NA	$0.66
Ready to Serve Customers	$12.00	$24.00
Average Residential Bill	$39.85	$65.15
Average Bulk Customer/ERU Bill	$49.71	$80.14

ERU = Equivalent Residential Unit
gal = gallon of water (7.48 gallons of water = 1 cubic foot)

Commission staff is reviewing the company's supporting financial documents, books and records.

Conclusion

Take no action on this filing at this time.

Answers to Issues and Questions from the Rosario Property Owners Association at the June 6th UTC Commission Hearing by Washington Water Service Co. and Rosario Utilities, LLC.

1) Design selection of the treatment plant:

Olympus knew at the time of purchase that the water plant needed to be replaced, and was investigating two types of treatment -- the Hydroxyl plant and slow sand filters. Olympus and utility staff met with the presidents of RPOA, Vusario and the Highlands to discuss these options. Within six months of the purchase, the Health Dept. issued an order to build a new plant within seven months or be subject to heavy fines. Because of this deadline, Olympus had no choice but to proceed with the Hydroxyl plant, because slow sand filters require a one-year pilot test to monitor effectiveness. The Hydroxyl plant was closer to a conventional plant, so it could be built more quickly and the Hydroxyl Company assured the utility that seven months was ample time to install the plant at a lower capital cost. Confident of the design, DOH endorsed the Hydroxyl plant subject to water quality requirements.

2)) Extra costs of the treatment plant:

Additional costs of the treatment plant did not arise through any actions of Rosario Utilities or Olympus.

Water treatment plants are site specific, requiring extensive engineering since the water to be treated varies widely. It is a common occurrence that plant modifications are required during commissioning in order to tailor operations to this site. As a specific example in our case, unforeseen electrochemical reactions triggered two successive redesigns, each requiring review and approval by DOH, and each successive review took three months or more.

Other incremental costs included:

- *The trenching to connect the plant to transmission and distribution lines required unexpected drilling and blasting.*
- *The automatic transfer switch for one emergency generator failed and had to be replaced.*
- *Safety upgrades to the electrical system were required by Labor and Industries.*
- *After the plant was completed, the 1972 telemetry line from the lake pumps failed, and had to be replaced.*

- *Seed money (survey, permitting, engineering, transferring hydropower rights to domestic use, and consultants) related to the plant development has never been recovered and is being proposed as part of the rate base.*
- *One cost not charged to the customers was the housing of Hydroxyl technicians and employees at least five days a week during this two-year period.*

3) Washington Water Service Co. participation in the rate case:

The customer comments assume incorrectly that Washington Water Service Co (WWSC) is proposing the rate case. In fact, the rate submission is requested by Rosario Utilities, LLC, because in recent years Rosario Utilities has not been recovering all its costs of operation from customers. The rate request is not retroactive, so customers have received a break from Rosario Utilities for the past two years. WWSC is assisting Rosario Utilities with this rate case request in anticipation of purchasing the water system assets and operating the water system after purchase. WWSC, or any other perspective buyer, will not purchase without a sufficient rate in place to recover its costs and obtain a reasonable rate of return on its investment. It should be pointed out that economies of scale with a large utility (WWSC) are benefiting the customer with a lower rate base then if Rosario Utilities was not being sold.

4) Operating Costs/Water Quality:

Although Rosario Utilities treatment plant is more expensive to operate than slow sand filters (which was not an option due to timing), the treated water is far superior. Staff is pleased to relate compliments from customers on water quality. Also note that when a huge potentially toxic blue-green algae bloom occurred in Cascade Lake two years ago, utility staff immediately conferred with DOH and made treatment adjustments and increased monitoring to protect their customers. The company was advised by DOH that the plant's treatment processes were superior in combating this type of problem. DOH has also referred other water systems looking to upgrade their treatment plants to come to Rosario and see the operation because of the high quality water product. The plant uses less chlorine than a conventional plant, which has been discovered to be safer for customers.

5) The interest rate charged on the loan:

The prime rate at the time of the loan in 1999 was 7.75% (refer to www.moneycafe.com/library/prime.htm) , and market rates are normally 2% - 3% over prime. Commercial lenders also require a compensating balance kept as a form of additional security, such keeping a balance in equity reserve, or pledging a letter of credit.

Small utilities are viewed as higher risk and as a result have higher loan costs and interest rates. There was no collateral and insufficient financial substance to secure conventional *financing and for this reason, local banks, which were contacted, were not interested in lending.*

The company does take advantage of opportunities to keep consumer costs down. The utility obtained a State Revolving Fund loan for the current upgrade with an interest rate is 1.5%. This loan took about 18 months from application to approval. It should e noted that not all applications were accepted. Even if Rosario Utilities' qualified for a loan at the time, though it is unlikely, since it was losing money in 1999 and lacked adequate collateral, the utility had no time to obtain a loan and build the plant under the DOH order. The loan and interest rate were approved by the UTC.

6) Unrecovered loan balance:

The surcharge and connection fees were expected to recover the cost of the loan and were all pertinent information at that time. Due to a subsequent DOH decision, not enough connections were approved to make this happen.

The surcharge and loan were authorized by the UTC in 1999 and not included in the 2002 rate case submission.

Yes, the company is proposing to roll the balance of the loan into the rate base, subject to UTC approval.

7) Water usage:

The resort pays for its share of water usage. We refer to the spreadsheets with actual customer water usage passed out to customers at the April 2nd meeting and/or the rate filing. The percentages of water usage to percentages of revenue are very close.

ERU's have been calculated by independent consulting engineers and approved by DOH, in the utility's 2004 Water System Plan.

8) Water quality standards:

The company's rate submission includes recovering <u>operational</u> costs associated with the increased regulatory environment. Although DOH required that the new water plant be in compliance with known pending regulations, the EPA and DOH are continually changing regulatory requirements. Every year there are improvements and additional monitoring requirements, which include compliance with the EPA's Surface Water Treatment Rule, Enhanced Surface Water Treatment Rule, Interim and Long-Term 2 Enhanced Surface Water Treatment Rule, Disinfection By-Products Rule, Stage 2 Disinfection By-Products Rule, the Municipal Water Law, and others. Having excellent source water quality only means that our compliance rates will be better than other systems, however, the monitoring and sampling requirements still must be met.

9) Usage blocks:

Although the utilities already addressed this issue in its responses to customers e-mailed to the RPOA on June 4th, for the convenience of customers we'll restate it.

We are trying to encourage water conservation, not punish customers or trying to over-earn if usage is higher than expected. Rate structure has a very delicate balance. You need rates that return the UTC authorized rate of return, not more or less. Placing too much emphasis in the upper tiers can disrupt the whole process with wet or dryer than normal summers. With the resort, which has a high seasonal usage, having a high commodity charge provides too much of the revenue stream in the summer months, thus making the water system too weak financially in the winter months, and also susceptible to summers with poor resort occupancy.

10) Pro-forma test year and history:

2006 is the test year for the utility, with an adjustment for staffing changes. As an operator of multiple water systems, WWSC is uniquely positioned to pass on savings to Rosario customers with economies of scale. Incorporating WWSC proforma was done to demonstrate a reduction in costs to the customers. If Rosario Utilities submitted its rate request based on actual Rosario expenses, the rate request would be higher than it is now.

11) Plant capacity:

The current plant has no additional capacity. Current expansion plans anticipate residential development and resort development. Residents and the resort have a right to water, and for each ERU, a connection fee is charged – the same fee for each. The utility takes customers requesting connections on a first-come, first-serve basis. As the resort develops, it will be required to purchase connections, paying for their share of the treatment plant. At some point, the capacity of the treatment plant will have to be expanded one more time and the resort will have to pay for its portion of plant capacity. Future resort development will require an agreement with the utility for plant capital which only benefits the resort. That developer agreement is subject to UTC approval.

12) Future capital improvements:

When future capital improvements affect residential customers, notice will be given and rates and/or surcharges will be vetted by the UTC with open hearings.

13) Rate recovery percentages:
These are two different numbers that answer two different questions. One – the 60%, shows the portion of both Operating Expense and Return on Investment that is covered by both the base rate and ready to serve charge. The second – 88%, shows what portion of only the operating expense is covered in the base rate and ready to serve.

14) History of the water plant installation:

Olympus purchased Rosario Resort and the utility on October 13, 1998. A formal complaint was filed with the UTC against Rosario Utilities on January 20, 1999, and the DOH order to build the plant in seven months was filed on April 8, 1999.

15) Filing documents:

The utility submitted its filing in good faith and has and will continue to fulfill all data requests and requirements of the UTC.

16) Customer questions to the utility:

Both WWSC and Rosario Utilities have tried to be forthcoming and have made every effort to be responsive to customer requests. In fact, the companies made a point to advise customers of the pending rate application in an open meeting (with UTC staff present by phone) conducted to answer questions on April 2nd, six weeks prior to the May 11th filing. Much information was disclosed in this meeting, however most questions from the customers were not expressed until the UTC hearing on May 23rd. Rosario Utilities has always stood willing to answer questions.

July 17, 2007

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To the attention of Commissioner Sidran, Oshie, Jones & Staff:

Attached is quite a long document created with diligence by two of our residents in response to the answers, received from Rosario Utility staffer Chris Vierthaler, to our many questions presented previously to you. While it is understood that repetition can be tiring, RPOA has left this document largely intact because of relevance and importance regarding this issue. The "answers" given to RPOA by the Olympus & utility staff have often been misleading and simplistic, providing virtually no clarity on the issues. Whether this is purposeful or due to a lack of research and openness on Olympus' part, is unknown.

Olympus has stated that with the recent separation of the water rights from the land enough water rights to serve the current users, along with a few extra, have been transferred to the utility. In fact, it is not enough for the complete development of the residential area. Previously these rights had always been part of, and transferred with, any sale of Rosario Resort. Now Olympus has discovered that what they received in their purchase of the resort at no added cost has potentially great value as a commodity. Rosario Property Owners as well as residents of the Highlands, Vusario, and Otter's Pond believe that **all** water rights necessary for the **complete** residential build-out of the RU service area, apart from the Rosario Resort Master Plan build-out, should be transferred at no cost with the sale of the utility.

The questions & comments presented over these last few months have demonstrated that the closely held relationship between the resort, the utility and Olympus has resulted in imprudent decisions in regard to the customers served by the utility. Imprudent because Olympus' organizational frame of reference is expansion of real estate in order to turn a profit for its stockholders. They are not, and do not claim to be experts in utility management. Their efforts and money have been directed towards the master plan, not the current management or upkeep of the resort, nor the running of the utility from the perspective of a long-term investment. This simply is not the mission of Olympus. Olympus purchased Rosario Resort with the intention of defining a master plan in order to resell it at a profit and Laurie Cameron indicated that the acquisition of the utility was not in their area of expertise. As a result, the relationship is fraught with debate and distrust because no one, not even the UTC, can really see what is going on between the 3 sets of books.

Olympus has repeatedly stated that they were forced into their choice of the Hydroxyl plant by the Department of Health order. We decided to ask the DOH if this was true. Attached are 3 emails from Steve Deem at DOH stating that this is NOT true. The Rosario community opposed the choice of the Hydroxyl plant. The untested plant required many expensive modifications resulting in cost overruns and more importantly a significantly more expensive system to operate in the long run.

Consequently, we ask that the UTC take these overruns, $216818 according to RU's calculations, out of the rate base and require Olympus to absorb them. We ask that they not be buried within the purchase or the rate case proposal in any way. There is no fairness in asking the community to absorb the overruns when, as Jim Ward says in his 6/26/2002 rate case report "the decision to not use customer input was the utility's." Olympus' choice to absorb the remaining balance would truly help to rectify the perceived imprudence regarding the management of these closely held subsidiaries. Additionally of course, the rate increase should be reduced to reflect this decision.

Olympus has acted strictly out of a self-serving and short- term investment mentality at the expense of the customer base the utility serves. This is also demonstrated by their failure to reduce the loan interest rate when national rates dropped combined with the benefit to the parent company of a quick depreciation schedule. Had the interest rate been reduced, as recommended by Jim Ward to the Commissioners on April 10, 2002 Docket UW-020307 and June 26, 2002 "Staff's Response: Staff has asked the same question of the Company and has determined the appropriate return on affiliated loans should be 6.75 %." $1000000 over 7 years at 6.75% would have saved $104,620 in interest! As a result, the ratepayers would not now be looking at $279000 of unpaid loan balance rolled into the sale of RU, and into the rate base forever. We also request that the UTC now hold Olympus accountable for this decision by reducing the remaining loan balance by $104620 to reflect the overage in interest.

Finally, to quote Duane Franklet and Lee Goodwin, "What we find missing from the system is incentive to opera utility efficiently and at a low cost to the consumers. Unilateral value judgments can be made by owner Olympu affect the annual results. What experience did Olympus bring to RULLC? What interest in the utility? They bel that a high rate of return may be realized from the sale of water rights and the sale of property for development according to the Master Plan. Apparently, they do this part well, but the utility system has suffered. Why reward mediocre results with the top return allowed? People need incentive to perform well, and we have to wonder wh doesn't WUTC include incentive performance as part of their regulation of a monopoly?" We find this last state very interesting particularly in light of the UTC mission statement ensuring fair rates through equitable business standards.......actions consistently reflect our values...one of which is honesty.

The RPOA has provided the UTC with a great deal of valuable information and a thoughtful perspective on a co issue. The attached document offers additional perspectives we hope you will take heed of, along with the comm you have heard at previous hearings.. What rings out so very clearly is the fact that Olympus has made decisio benefit them as the parent company and their mission of developing the Rosario purchase into a highly profitable acquisition. One cannot really hold them at fault for this alone. It is the fact that they have not managed the utili diligent attention and commitment, as one would have had it truly been a stand-alone entity. For this reason the l must hold them accountable.

We, the community served by Rosario Utility, seek the following:

- Rates based upon actual data, not future projections, which are fair and reasonable
- Enough water rights transferred to the Utility to serve ALL of the properties/lots within the Rosario Utilit service area
- Full separation of expenses attributable to the resort
- Elimination of the $216818 in its entirety from the rate base and fees
- Reduce the remaining loan balance by $104620 to reflect the interest savings had they financed at 6.75% years as recommended by staff.
- A Utility operated with a balance of business sense and community responsibility.

Respectfully submitted by,

The Rosario Property Owners Board

Deborah Carruth

Jobin Suthergreen

Carl Yurdin

Carol Marcin

Eileen Pyka

The following communications are a combination of Olympus/RU, DOH, and RPOA. Olympus has represented for years that they were forced to choose the expensive hydroxyl plant by the DOH. It has been disputed over and over that Olympus bears no burden in the cost of the hydroxyl plant and the cost over runs in existence amounting to some $216818. This remains a critical point for RPOA. The following communications demonstrate Olympus's repeated mantra of undue pressure by the DOH and yet Steve Deem of the DOH says otherwise. It has been made quite clear by Laurie Cameron that the business of Olympus is to purchase property, expand its potential and sell it at a 25% and more profit. It has been stated that the hydroxyl plant was the quickest and the least expensive to build, which supports the mission of Olympus. Additionally, Laurie Cameron has stated that "we are not in the utility business" stating that decisions were made from a frame of reference other than expert in the area. ***Note: RPOA comments in black & this typeface: ***Others comments in blue and italic***

Mike Ireland's response (#12) to our questions regarding cost over runs dated 6/04/07:

"Cost over runs on the water treatment plant totaled $216,818 and are now considered part of the total plant value. By court order, the company was given very little time by the WA State Dept. of Health to build the new plant. The Health Dept. also waived normal testing of the treatment processes prior to construction, with these tests and monitoring done at completion instead. Unfortunately, the original treatment process proved to be cost prohibitive, so many modifications occurred during construction."

On 6/18/07 a second set of responses were received from Chris Vierthaler, including the following regarding the design selection of the treatment plant:

1) <u>Design selection of the treatment plant:</u>

"Olympus knew at the time of purchase that the water plant needed to be replaced, and was investigating two types of treatment – the Hydroxyl plant and slow sand filters. Olympus and utility staff met with the presidents of RPOA, Vusario and the Highlands to discuss these options. Within six months of the purchase, the Health Dept. issued an order to build a new plant within seven months or be subject to heavy fines. Because of this deadline, Olympus had no choice but to proceed with the Hydroxyl plant, because slow sand filters require a one-year pilot test to monitor effectiveness. The Hydroxyl plant was closer to a conventional plant, so it could be built more quickly and the Hydroxyl Company assured the utility that seven months was ample time to install the plant at a lower capital cost."

RPOA would like to point out that Olympus/RU has repeatedly stated that they worked directly with the neighborhood in making this decision, when in fact the following test from Jim Ward's report dated 6/26/02 states otherwise.

"Treatment Plant: Customers believe the purchase of the Hydroxyl water treatment system was not a prudent decision. The customers had significant concerns regarding the Company's decision to purchase the Hydroxyl water treatment system instead of another type, such as a slow sand filter system. The customers wanted to know who made the decision and if it was the correct decision. The customers do not understand why the company did not allow their input

in the decision of which treatment system to purchase. The customers stated that they have engineering and contract expertise, which they offered to the Company, but were refused."

The history related above implying Olympus had no choice, is not true as shown by this recent exchange between Sandy Taylor of Olga Water Users and, DOH's, Steve Deem:

> ***Email from Steve Deem, DOH to Sandy Taylor June 25, 2007:***
> ***I was the engineer for the State Dept of Health (DOH) at the time in question and do remember some of the issues! DOH did not pressure Rosario to rush the design of a new treatment plant and in fact***
> ***favored slow sand filtration for this utility setting. The Departmental Order (DO) was issued in April of 1999 due to several violations and failures. Section 1.8 of the DO lists a sequence of events relative to Rosario "Failure to construct water treatment facility ...." that may clarify the issue. On December 4, 1996 DOH issued a review letter explicitly concurring with Rosario's decision to pursue installation of a slow sand filter and setting up piloting parameters. On June 3, 1997 Rosario sent a letter proposing an alternative treatment option. On July 22, 1997 Rosario submitted an engineering report for a new treatment facility. On November 20, 1997 DOH approved the engineering report. Rosario did not submit the required construction documents for the treatment facility. As stated previously, DOH finally issued the Department Order in April 1999 after no action by Rosario. This DO was issued over two years after Rosario had received the OK to proceed with Slow Sand Filtration.***
> ***Steve Deem, WSDOHIn a separate email from Deem on June 19:***
> ***From Deem, Stephen (DOH)To: Duane FrankletSent: Tuesday, June 19, 2007 8:48AM***
>
> Subject : Olympus/WWS/RU answers to questions from last Thursday The answer to the first question is not accurate. Moran State Park Cascade Lake Water System slow sand (SSF) treatment plant did not conduct one year piloting before receiving DOH design approval as required. Moran SSF design used sand specifications and the same sand supplier as other Orcas Island SSFs and utilized a very conservative filter design rate to justify that no pilot was needed to appropriately size the water treatment plant. (Moran's SSf has performed excellently). The same avenue was open to Rosario.

It seems quite clear from the above that if Olympus had simply communicated properly with Mr. Deem in Jan-March 1999 that you were working hard striving to make the right plant decisions, the "Department Order" in April setting a 7-month deadline could quite easily have been avoided, and the slow sand filter alternative (favored and approved by DOH and the several user-group engineers) proceeded with. The failures of previous owner management was not Olympus'fault, but after you became Rosario owners on Oct 13, 1998 the subsequent communication lapses with DOH were due to *your* mismanagement of the problem, and need not have been that way. The water experts in the

customer group knew that your decision to go with Hydroxyl plant was a huge mistake, which you ignored. Ozone treatment has been the preferred system in Europe for the past century. Although this technology was known, Hydroxyl had not built such a plant nor had an operations experience with same. Gray and Osborne and Livingstone Associates recommended the Hydroxyl system, but we believe they did so on the basis that the technology was well developed and available. The design capacity of 220 gpm has yet to be met, the filtration unit delayed the plant operations, required replacement with another type of filter and had to be expanded. Cost overruns were considerable. This is the factual history, and we believe Olympus must bear the responsibility and extra costs resulting from it's misguided decision in '99-2000. We recognize that it's impossible to quantify exactly how much lower Operating Costs with a SSF system would have been over the years since, but most experts feel it would have been substantially lower, and such plant likely would have had a far longer useful efficient life than the current plant. We believe the sale price to WWSC is excessive, considering the unknown (not assessed) remaining life of this plant and ability to obtain replacement parts that are cost-viable, and that atvery least the transfer (rollover) of $175,000 debt should be removed from the purchase agreement and the Rate Case; that Olympus should responsibly absorb that.

2)) Extra costs of the treatment plant:

Additional costs of the treatment plant did not arise through any actions of Rosario Utilities or Olympus.

We believe the evidence above proves the contrary; that it was Olympus' unilateral misguided actions that caused water users extra costs, for the past 7 years and continuing on into the future.

Water treatment plants are site specific, requiring extensive engineering since the water to be treated varies widely.

True, but RU could have built a standard SSF plant and adjusted for field conditions. This was the first, and last such plant that Hydroxyl built; their experience was lacking, including knowledge of WA Labor & Industries safety requirements. Apparently no effort was made to determine filtration requirements at the time. The conclusions that we have had since 2000 were that it was poor design, which our engineering experts clearly stressed to you at the time, thus an inadequately thought-out management decision. We believe WWSC's purchase price is grossly excessive and unjustified (as stated in #1 above), also considering that the distribution lines are very old and will soon need to be replaced as they start leaking more and fail (they're apparently already leaking around 20% of the output)

It is a common occurrence that plant modifications are required during commissioning in order to tailor operations to this site. As a specific example in our case, unforeseen electrochemical reactions triggered two successive redesigns, each requiring review and approval by DOH, and each successive review took three months or more. Because it was a new unproven approach and system to them.

Other incremental costs included:

- ***The trenching to connect the plant to transmission and distribution lines required unexpected drilling and blasting.*** This is a common construction problem around all of Rosario Hill, and should have been anticipated.

- ***The automatic transfer switch for one emergency generator failed and had to be replaced.*** If not under warranty, wasn't this classified as "maintenance"?

Λαβορ ανδ Ινδυστριεσ ρεθυιρεδ • Σαφετψ υπγραδεσ το τηε ελεχτριχαλ σψστεμ. This is attributed to lack of thorough design and proper management review to ensure compliance at the outset.

- ***After the plant was completed, the 1972 telemetry line from the lake pumps failed, and had to be replaced.*** Why is this not considered "maintenance"?

- ***Seed money (survey, permitting, engineering, transferring hydropower rights to domestic use, and consultants) related to the plant development has never been recovered and is being proposed as part of the rate base.*** **Were these not part of the plant estimate? Why not? The contract covered land clearing and building, survey and permitting, engineering, and legal and misc. as per Ward's recommendations to the commissioners.**

- ***One cost not charged to the customers was the housing of Hydroxyl technicians and employees at least five days a week during this two-year period.*** But we believe this was included in the contract with provider; we believe that users in fact paid for it thru the contract price, thus the rates.

3) Washington **<u>Water Service Co. participation in the rate case:</u>**

The customer comments assume incorrectly that Washington Water Service Co (WWSC) is proposing the rate case. We are not assuming this and never have. We have simply repeated what Mike Ireland told us on May 23rd—that he did all the numbers on the spreadsheets. And so our question was: if he inserted all the numbers,but it wasn't his rate case, and WWS hadn't even filed for the purchase, and we weren't supposed to talk about WWS because it wasn't their rate case, how was it that he was allowed to present all the numbers for the case?

In fact, the rate submission is requested by Rosario Utilities, LLC, because in recent years Rosario Utilities has not been recovering all its costs of operation from customers. The rate request is not retroactive, so customers have received a break from Rosario Utilities for the past two years WWSC is assisting Rosario Utilities with this rate case request in anticipation of purchasing the water system assets and operating the water system after purchase. WWSC, or any other perspective buyer, will not purchase without a sufficient rate in place to recover its costs and obtain a reasonable rate of return on its investment. It should be pointed out that economies of scale with a large utility (WWSC) are benefiting the customer with a lower rate base then if Rosario Utilities was not being sold – this is a hollow unsubstantiated argument, since it has not been explained to users with any evidence or examples by WWSC how O/C savings from economy of scale should result to user's benefit. It sounds great in theory, but lacks any substance, and

WWSC instead have had a 12.5% year-to-year company-wide Oper Cost rise between '04-'05 (the last year shown in their data), thus we see no evidence to expect any savings from them. And WWSC has not answered our question about how they got their estimated $44.55 O/C per customer for us if they'd managed RU in 2006. That's twice their statewide average O/C, indicating quite clearly they plan on showing no savings to us from their broader base. RU cannot rationally argue that O/Costs in detail are none of our business; we believe they most certainly are, that we're entitled to it. One of our user-group's most important goals is to make certain that Day One of WWSC ownership starts out with fully understood proven costs for the new rate base, so that approved or overlooked mistakes in past costs are not compounded going forward.

5) The interest rate charged on the loan:

The prime rate at the time of the loan in 1999 was 7.75% (refer to www.moneycafe.com/library/prime.htm), and market rates are normally 2% - 3% over prime. Commercial lenders also require a compensating balance kept as a form of additional security, such keeping a balance in equity reserve, or pledging a letter of credit.

Small utilities are viewed as higher risk and as a result have higher loan costs and interest rates. There was no collateral and insufficient financial substance Of the parent company?? ***to secure conventional financing and for this reason, local banks, which were contacted, were not interested in lending.*** This seems to us an illusory argument. We understand Olympus simply decided to lend from it's own capital the $1M to RU, and thus Olympus had great flexibility to amend the terms during the payback duration. One can argue a myriad of methods in which Olympus could have charged interest to its own subsidiary (again benefiting both entities)…even if they had charged prime at 7.75% for the 7 years, interest saved would have been over $63000.

Average Prime was (during each year): 2001/7%, 2002/4.75%, 2003/4.125%, 2004/4.25%, 2005/6.0%. Who benefited from maintaining the artificially high 9.25% rate for 7 years? Only Olympus; certainly not the users whom you claim you're protecting and not taking advantage of. No borrower who was paying the interest themselves would have kept a 9.25% Note for that duration when it could have easily been refinanced at much lower rate, and surely Olympus would have done so, as good everyday business practice, if they were a borrower. You were simply shoveling inflated interest cost onto customers and profiting enormously. This has been inexcusable deliberate gouging of your customers; it can't be called anything else. It was not an accidental oversight; in fact you told us that Olympus decided it was best for them to keep charging us the 9.25%. Rates should not be built on unreasonable practices like this, and it's no way to treat customers, captive or not.

6) Water usage:

The resort pays for its share of water usage. Not accurate. ***We refer to the spreadsheets with actual customer water usage passed out to customers at the April 2nd meeting and/or the rate filing. The percentages of water usage to percentages of revenue are very close.*** The 2006 consumption data from the WWS spread sheet show that Resort consumed

63,688 gals/ERU, Cascade Harbor Inn consumed 81,126 gals/ERU and Rosario residences consumed 48,289 gals/residence. **There is a mistake on one of WWSC sheets, labeled "Rate Comparison" between customers; the figure of 5,307 Residential average gallons used per month/ERU in '06 is wrong - it should read 4,204, based on the spreadsheet "RESIDENTIAL METERED CUSTOMERS RATES".** Rosario Resort consumed over '06 32% more water per ERU than the residences. **That's far from being equal**.

Also the above values are for average consumption for 2006. To equitably allocate the cost of plant capacity, peak consumption is necessary to be taken into account. If the peak monthly consumption of August 2006 is used as the basis for allocating costs, Rosario Resort increases to 158 ERUs and Cascade Harbor Inn increases to 70 ERUs. Historically the residence users have paid more than their share of all of the costs, as the ERUs for the Resorts have been kept **artificially** low, and changes **to this number** implemented in a most tardy fashion. We feel strongly that before this rate proposal can be considered by the commissioners that the Health Department must reevaluate the capacity and ERU count and the UTC include the DOH findings in their review of the rate increase proposal.

***ERU's have been calculated by independent consulting engineers and approved by DOH, in the utility's 2004 Water System Plan*.** We note that the draft of this Water System Plan was filed in 2002 with the completed report filed in 2003. Approval for both Resorts of 132 ERUs by the DOH came on January 13, 2004. This increase was not inserted into the Annual Water Company's Report until 2006, a sleight of hand that cost the users.

10) Pro-forma test year and history:

***2006 is the test year for the utility, with an adjustment for staffing changes. As an operator of multiple water systems, WWSC is uniquely positioned to pass on savings to Rosario customers with economies of scale. Incorporating WWSC pro-forma was done to demonstrate a reduction in costs to the customers*.** Not that we can see; the pro-forma does not show what economies of scale there are.

11) Plant capacity:

The current plant has no additional capacity. Current expansion plans anticipate residential development and resort development. Residents and the resort have a right to water*–** Yes, and we believe vacant lots also have a right for water and rights for them should be protected in the sale - not just left out in the cold****, and for each ERU, a connection fee is charged – the same fee for each. The utility takes customers requesting connections on a first-come, first-serve basis. As the resort develops, it will be required to purchase connections, paying for their share of the treatment plant. At some point, the capacity of the treatment plant will have to be expanded one more time and the resort will have to pay for its portion of plant capacity. Future resort development will require an agreement with the utility for plant capital, which only benefits the resort. That developer agreement is subject to UTC approval.***

A 10% reduction in leakage loss would provide about 40 more connections. Why have RU made seemingly no effort to find and repair piping leaks? The explanation also involves ERU re-determination by DOH.

The Environmental Impact statement for the Master Plan says that the level of leakage is unacceptable. Chris estimates it's about 20% leakage, which in addition to the 5-7% backwash used in the plant represents a whopping 25% of plant output. We think that magnitude of waste is unconscionable, beyond reason. Steve Deem has stated that leakage in a properly managed system should be less than 10%. Our conclusion is that RU have made virtually no effort to find and repair the leaks, since YOU have LITTLE incentive to do so when the residential users are paying for a large portion of the cost of producing the wasted product.

** Orcas Highlands Assoc. has a "Water Service Contract" dated Jan 1, 1980 with Rosario a/o Gil Geiser or assigns (which we assume Olympus inherited along with the other purchased obligations) which states that Rosario will continue supplying water upon demand to the residents (including future residents as they are constructed) of any of the land previously owned by Rosario Highlands Inc. In other words, all of the Highlands lots that Geiser subdivided and sold in the '70s and early '80s. Highlands and Otters Lair has 20 lot owners who have not yet built and do not have hookups or RTS status, and water rights for them must be protected. And there are likely several such vacant lots in the Rosario residential area as well, who must be protected.

12) Future capital improvements:

When future capital improvements affect residential customers, notice will be given and rates and/or surcharges will be vetted by the UTC with open hearings.

You stated that improvements are underway which will allow about 100 more hookups within a few months. Question 11 above you stated that the current plant has no additional capacity, so we'd appreciate knowing how you intend to allocate those, to first cover the 88 RTS's? We believe BETTER management practices Could reduce the water loss and allow about 40 new connections, which would position the system at the currently allowable 456 connections/ERUs. Why does RU plan to ask existing customers to pay for part of the improvement costs? Someone said that RU stopped the work on the improvements that started in January. If this Is true, why? What actual improvements does WWS see in the next couple of years? At what cost to be allocated to the users?

Additional Questions to RU:

17) Rate Case spreadsheet errors:We've pointed out that '06 consumption data for Highlands (bulk buyer) is greatly overstated due to large leaks around the Otters Lair pond that were difficult for Highlands Assoc to find, but were fixed in Nov 06, resulting in consumption (at RU hand-over meter) since then being 40% of what it had been in corresponding months a year earlier. (Nov Highlands consumption was 1,244,200ga; in Dec after leak fixed it fell to 265,600). Erroneous use by WWSC of consumption during the leak period leads to overstated fictitious revenue assumptions in their Rate Case projections, and also artificially low ERU counts for the Resort. Historically Highlands residences use less water than the Rosario residences, and data since Dec (after leak was fixed) also confirms that Highlands uses less per connection than Rosario residences.

An error corrected by WWS on their "Rosario Resort Metered Worksheet, Old vs. New" spreadsheet for 2006 shows the corrected value on line D44 as 63,688 ga/yr/ERU. The correct corresponding value for Rosario Residences is 48,289 ga/yr/connection. The corrupted data for Highlands (due to it's large leak building up over all of '06 until was fixed in

Nov) is correctly not used. But the 5 months hard data after leak fixed, i.e. Dec 06 to Apr '07, if used with an approximation of normalized usage by Highlands for the other 7 months (or simply basing Highlands assumed usage on Rosario Residence usage) would give annual Highlands usage closer to reality than the approach used by WWS in the spread sheet. This would lead to a further increase in the ERU count for the Resorts, which we believe must be taken into account for the Rate Case and going forward.

We would like to raise the question why the approved ERU counts for Resort approved on Jan 13, 2004 were not implemented until Jan 1, 2006, some two years later? This delay avoided charges that the Resorts should have paid RU, inflating RU's "loss" in those 2 years.

18) <u>Olympus' past efforts to sell RU:</u>

Laurie Cameron stated at the Jun 14th meeting with water customers that they've tried repeatedly over recent years to sell the utility and excess water rights as a package to a local Orcas buyer, had discussions with Eastsound Water Users Assoc and separately Eastsound Sewer & Water District, but that they could never reach agreement. We realize that a large part of the hang-up was that neither of those user groups wanted to buy the Utility (perhaps because of it's complexity), were only interested in the excess rights, but surely with some creative thinking incentives might have been put forth by Olympus to make taking RU more palatable and interesting as part of the package with the "easy cream" of excess rights. Everyone knows that Eastsound needs the water, particularly under GMA requirements that future population be focused there. In addition Rosario Property Owners Assoc (RPOA) wrote to Olympus in 2001 or 2002 requesting to buy RU, but never got a reply from Olympus. So from the users perspective it does not seem that Olympus made anywhere near a sufficient diligent effort to work out a "win-win deal" with an Orcas community buyer, so that the rights and system could remain locally owned on Orcas where it logically should, and we submit where both Robert Moran and Gil Geiser intended that it should be kept. To the users, the argument "we tried and could never get far" lacks credibility.

Respectfully submitted,

Rosario Property Owners Association

Prepared by:

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August 21, 2007

UTC Commissioners Sidran, Oshie, Jones and Staff
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, WA 98504-7250

RE: Rosario Utilities Rate Application
UW-070944

Below is a response to the customer comments submitted to the UTC five business days before the last scheduled hearing date. All of the issues have been addressed several times in both written and oral presentation format. Once again, Rosario Utilities ownership and staff join together to provide the following responses:

RESPONDING THE COMMENTS BY DUANE FRANKLET AND LEE GOODWIN:

1. ***Design selection of the treatment plant***

The Hydroxyl plant was selected for the following reasons:
1) It was recommended by two independent, highly respected Seattle based engineering firms.
2) It had a considerably shorter construction time frame.
3) The construction cost was projected by the engineers to be 27% less then slow sand.
4) DOH willingness to approve the Hydroxyl plant.

Oly Rose acquired Rosario Resort and RU in October of 1998 and promptly set to planning for the revitalization of these distressed assets. Judging from the condition of the property at the time of purchase, the resort was loosing significant money and the utility needed significant capital. It appears in the years leading up the sale, the prior owners lacked the ability to respond to the long standing needs of the property which created simmering acrimony from the utility users and growing concern by the DOH.

Within 6 months of acquiring these difficult and complex assets, Oly Rose committed to replace the water plant with the expert-recommended option. Regrettably years of user resentment had reached the boiling point and Oly Rose has since been blamed for the inaction of the prior owners.

The statement that DOH would have been willing to negotiate a longer timeframe for installation of a slow sand filter approach and/or waive the testing period based on their willingness to do so for Moran State Park bears little comparison to RU which serves a considerably larger, year-round public user base which, from all evidence, would not have been tolerant of the additional time and costs required to negotiate an alternative approach with the DOH.

2. ***Extra costs of the treatment plant:***

Yes, there were costs in addition to the original scope of the project, which the company paid and is now incorporating this cost into the rate base. Invoices have been provided to the UTC. Regarding "maintenance" costs -- replacing equipment valued at several thousand dollars is normally capitalized, and that is what the company has done.

The cost of the plant also came up in the 2002 rate case, and the company validated the expense at that time. It seems logical that review of the issue at the time it occurred, which is what happened, was more appropriate than trying to second guess events five years later.

3. ***Washington Water Service Co. (WWSC) participation in the rate case:***

WWSC took 2006 figures from Rosario Utilities and demonstrated cost savings by showing what Rosario Utilities could have requested for an increase in rates without WWSC's "blended" rates for 2007 because of the upcoming sale. There is a cost savings to the customers, which have been pointed out several times. Two specific examples of economies of scale are centralized billing and the existing WWSC insurance including Rosario Utilities, saving thousands of dollars per year.

4. There was no question #4.

5. ***Interest rate charged on the loan:***

Olympus normally secures debt for all acquisitions as it helps lower the overall cost of invested capital. Every effort was made by Oly Rose to put debt on both the resort and the utility. Even with the real estate and improvements available as collateral to secure debt on the resort side, Oly Rose was unable to find a willing lender at a competitive rate. In over a billion dollar portfolio, Rosario was the only acquisition unable to secure financing. It was not until 2002 when Oly Rose acquired the Round House as part of the resort that a local lender was willing to extend a loan. The interest rate was 10.5%. Prime at the time was 4.75%. We did the loan. If lenders were unwilling to provide debt to the resort except at near userous rates, it seems entirely clear that there would be no lenders interested in providing debt to a utility loosing money with a failing infra structure. In fact, at 325 bps over prime for the period of the RU loan, the interest rate was quite favorable and considerably below a reasonable return on equity. As pointed out before, where possible, RU has made every effort to take advantage of favorable loan opportunities as evidenced by the state loan for the plant expansion. That application period was over 18 months and there was no assurance that it would be forthcoming. Finally in issue # 2 above the users state "We believe WWSC's purchase price is grossly excessive..." That being the case, perhaps it is even more clear why a lender would not have been willing to provide debt to an entity worth considerably less than the loan amount.

6. ***Water Usage:***

Metered usage by customer class has been provided to the UTC showing that the commercial usage totaled 32.2% of water in 2006 and paid 31.7% of the total revenue.

The resort water usage has been evaluated by consulting engineers with each water system plan. Water usage for all classes is subject to revision with an updated plan. Plant capacity is not the same as an Equivalent Residential Unit (ERU). ERUS are based on the average water use, and this has been used for billing purposes. A revision to the utility's ERU is a submittal to DOH made by the company with water use analysis completed by a professional engineer.

The Water System plan was approved in May 2004 and new rates went into effect that summer after providing appropriate notice to the commercial customers involved.

7.. No question #7, 8, or 9.

10. ***Proforma test year and history:***

An updated proforma has been submitted to the UTC. UTC staff is also completing their own proforma, based on the audit.

11. ***Plant Capacity:***

This heading is confusing in the customer comments as the question is about water rights for future customers and distribution leakage. Water rights for plant expansion to serve residential customers are available. However, because the water company will have to buy the water rights, these costs will be passed on to new customers. That way growth will pay for growth and current customers will not unduly subsidize new customers.

Yes, the utility's leakage and unaccounted for water is about 20%, which similar to many other water systems, including the Eastsound Water Users Assn, one of the organizations which customers would like to see own the utility. Other water systems on Orcas Island, such as the Doe Bay system, have unaccounted for water at over 30%. The goal of the municipal water law is to reduce lost and unaccounted for water down to 10% in the next several years, which was what Steve Deem of DOH was getting at in his comments. Any costs associated with reducing this lost water will ultimately be put into the rate base.

12. ***Future capital improvements:***
Current improvements are underway to improve plant capacity. The work has not stopped, however it has been a slow process. Part of the project will expand capacity and part of the project will benefit current customers. For example, the piping upgrade will benefit all customers.

13. No question 13, 14, 15, 16

17. *Rate Case spreadsheet errors:*

The company apologizes for an error within the "Rosario Resort Metered Worksheet". Metered usage for the Orcas Highlands in 2006 was accurate. Yes, there was a leak in 2006, which took a long time to discover and fix. With a master meter situation, leaks are harder to detect. The company understands that UTC staff will take this abnormal leak into consideration when reviewing the rates and rate design so that the analysis will be normalized to avoid any inappropriate outcome that the leak might otherwise produce.

18. *Olympus past efforts to sell RU:*

For over 3 years, Oly Rose engaged in negotiations with both the Eastsound Water Users Assn and the Eastsound Sewer District to find a way to convey RU and separate water rights interests. It is correct to say that even with the incentive of a water rights sale, neither East sound utility had even the most remote interest in RU. Since then, negotiations over the sale of the water rights have since been suspended pending the sale of RU.

It should be noted that during more than 3 years of negotiations with East Sound, Oly Rose at its sole expense retained the services of several consultants expert in their field to conduct studies for and on behalf of East Sound utilities demonstrating resources available and creative ways to take over the assets. To say Oly Rose lacked the will to make a deal is to lack knowledge about and appreciation for the time and resources devoted to that effort. When it became clear that no amount of 'creativity' on Oly Rose' part was likely to spur interest from an on-island entity, Oly Rose looked for an alternate buyer. WWSC seemed a perfect candidate with multiple comparable operations around the state of Washington thereby providing that experience level which the users claim is missing under current ownership. We frankly are confounded by the users apparent lack of enthusiasm.

Sincerely yours,

ROSARIO UTILITIES, LLC

Chris Vierthaler

Chris Vierthaler
General Manager

cc: Jobin Suthergreen, PROA President