

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	DOCKET UW-060343
TRANSPORTATION COMMISSION,)	
)	
Complainant,)	ORDER 04
)	
v.)	
)	INITIAL ORDER REJECTING
ILIAD WATER SERVICE, INC.,)	REQUEST TO MODIFY TARIFF
)	AND DENYING MOTION TO
Respondent.)	REOPEN RECORD
)	
.....)	

1 **Synopsis:** *This is an Administrative Law Judge’s Initial Order that is not effective unless approved by the Commission or allowed to become effective pursuant to the notice at the end of this Order. If this Initial Order becomes final, the request filed by Iliad Water Service, Inc., to modify initial tariff WN U-1 to allow a one-time assessment for customers of the Alder Lake Community Water System to fund the installation of a water chlorination system will be rejected. In addition, the motion to reopen record will be denied.*

2 **Nature of the Proceeding:** This is a request for tariff revision filed on March 1, 2006, by Iliad Water Service, Inc., (Iliad) to charge its customers a one-time assessment to fund the installation of a water chlorination system.

3 **Procedural history:** On March 1, 2006, Iliad Water Service, Inc., (Iliad), filed a tariff revision. Iliad proposed to charge its customers a one-time assessment to fund the installation of a water chlorination system. By Order 01 served March 29, 2006, the Washington Utilities and Transportation Commission (Commission or WUTC)¹ suspended implementation of the tariff and initiated an investigation. By Order 02 Prehearing Conference Order, an evidentiary hearing was scheduled in this matter. The matter was heard upon due and proper notice to all interested parties before Administrative Law Judge Patricia Clark on November 8 and 9, 2006, in Olympia,

¹ The acronym WUTC is used in this Order because that acronym is used to identify the Commission in several exhibits quoted in this decision.

Washington. In addition, a public hearing was convened in Eatonville, Washington, on November 14, 2006, to give affected consumers the opportunity to comment on the proposed tariff modification. The parties filed post-hearing briefs on November 29, 2006. On December 28, 2006,² Iliad filed a motion to accept late-filed exhibit.³ The Commission Staff (Staff) filed an opposition to the motion.

4 **Initial Order:** The presiding administrative law judge proposes to reject the request to modify the tariff and deny the motion to reopen record.

5 **Appearances:** The parties were represented as follows:

Complainant, Commission	by Michael Fassio, Assistant Attorney General 1400 S. Evergreen Park Dr. SW Olympia, Washington 98504
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Respondent, Iliad Water Service, Inc.	by Richard A. Finnigan 2112 Black Lake Blvd. SW Olympia, Washington 98512
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INITIAL ORDER

6 **Issues:** The principal issue in this case is whether Iliad's proposed tariff revision for the Alder Lake Community Water System (Alder Lake Water System) is just, reasonable, and sufficient.⁴ The tariff revision would fund a one-time assessment in the amount of \$132,795⁵ to comply with a Department of Health (DOH) Order to install a water chlorination system.⁶ The assessment would be divided equally among

² Consideration of the motion and response delayed the entry of the Initial Order by approximately one week.

³ Given the nature of the relief requested, it is a motion to reopen record.

⁴ RCW 80.28.020.

⁵ Iliad's tariff filing requested recovery of \$132,795 in either a one-time flat rate assessment of \$3,405 or through a monthly surcharge of \$49.26 for approximately ten years. Dorland, Exh. No. 17. Staff's financial analysis yielded project costs in the amount of \$125,183. In reply, Iliad modified its proposal to accept Staff's financial analysis thereby reducing the requested amount of the assessment. Dorland, Exh. No. 19 at 3:11-12; Kermode, Exh. No. 20 at 27:11-12; Kermode, Exh. No. 31:17. In its brief, Staff stated that it discovered an error in its calculation of project costs. Brief at 23, ¶53. Although Staff recommended that the tariff revision be rejected, if approved, the total Staff-supported cost of the project would be \$120,899 which results in a *pro rata* assessment of \$3,099. Brief at 23-2, ¶53.

⁶ Dorland, Exh. No. 19 at 3:12-14.

the approximately 39 customers of Alder Lake Water System.⁷ Customers of Alder Lake Water System would be permitted to pay their portion of the assessment in a lump sum in the amount of \$3,405 within 30 days of the effective date of the tariff or have a monthly surcharge in the amount of \$49.26 added to each water bill for a period of ten years.⁸

7 In the alternative, if the Commission concludes that Iliad acted improperly, Iliad proposed that the surcharge be limited to \$118,000.⁹ Iliad asserted that this is approximately the cost that customers would have incurred if the water chlorination system had been installed in the 2003-2004 time frame.¹⁰

8 Staff argued that the evidence does not support a finding that the proposed tariff revision is fair, just, reasonable, and sufficient and recommended that the Commission reject the filing.

9 Iliad bears the burden of proof that the proposed tariff revision is fair, just, and reasonable. Resolution of the principal issue requires consideration of whether the costs associated with the assessment for the installation of the chlorination system are reasonable. Iliad also bears the burden of proving that its decisions were prudent. Specifically, whether Iliad obtained prudent financing for the project and whether Iliad acted prudently in planning the construction of the project.

10 The traditional test for prudence is as follows:

In evaluating prudence, it is generally conceded that one cannot use the advantage of hindsight. The test this Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. The test applies both to the question of need and the appropriateness of the expenditures.¹¹

⁷ Dorland, Exh. No. 1 at 4:16-17; and at 5: 20-21.

⁸ Dorland, Exh. No. 17 at 2; Kermode, Exh. No. 20 at 27:17-18.

⁹ Dorland, Exh. No. 19 at 3:18-19.

¹⁰ Dorland, Exh. No. 19 at. 3:19-21.

¹¹ Staff Brief at 4, ¶8 quoting from *WUTC v. Puget Sound Power & Light Co.*, 1st Supplemental Order at 32-33, Cause No. U-85-54 (1984).

The Commission relies upon a reasonableness standard. The company must establish that it adequately studied the question of whether to purchase these resources and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions were made.¹²

- 11 ***Just, Fair, and Reasonable Tariff Revision:*** The most important issue in this case is the reasonableness of the financing mechanism chosen by Iliad because of the considerable costs associated with that form of financing versus the costs associated with other forms of financing. Therefore, resolution of this issue requires consideration of the prudence of the form of financing selected by Iliad to fund the chlorination project.
- 12 ***Prudence of Financial Planning:*** Iliad obtained a financing commitment from BHL Investments for a loan to fund this project.¹³ The loan is for a period of 10 years at the rate of 11 percent.¹⁴ The term of the loan and the interest rate have remained constant since the financial commitment was secured in January 2003.¹⁵
- 13 Staff opposed this form of financing because of the cost associated with this loan. The alternate form of financing supported by Staff is available through the Drinking Water State Revolving Fund (SRF). SRF loans carry an interest rate of 1.5 percent.¹⁶ This is clearly a lower interest rate option for financing this project but the evidence presented by Iliad is conflicting regarding the rationale for not pursuing this form of financing. On the one hand, Iliad argued that it had its engineer review and evaluate the SRF process and the engineer concluded that SRF financing was not available.¹⁷ In conflict with that evidence is Iliad's assertion that the increased costs and time in pursuing this form of financing would offset any interest savings along with no assurance that the loan would be approved.¹⁸ In reply, Iliad corroborates the former rationale.¹⁹

¹² Staff Brief at 4, ¶8 quoting from *WUTC v. Puget Sound Power and Light Co.*, 19th Supplemental Order at 10, Docket No. UE-92161, *et. al.* (1994), citing 2nd supplemental Order, Cause No. U-85-33 (1986), and 5th Supplemental Order, Cause No. U-93-26 (1984)..

¹³ Dorland, Exh. No. 11:1 and Dorland, Exh. No. 14:1.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Sarver, Exh. Nos. 65 – 70.

¹⁷ Dorland, Exh. No. 1 at 8:15-17.

¹⁸ Dorland, Exh. No. 16 at 4.

¹⁹ Dorland, Exh. No. 19 at 3:4-6.

- 14 In any event, the best source for information regarding SRF financing was the agency that administers these funds, DOH, rather than Iliad's engineer. Iliad did not contact DOH regarding its eligibility for SRF financing.²⁰ Nonetheless, Iliad either knew or should have known of its eligibility for this source of low interest funding.
- 15 Iliad admitted that it has received copies of the newsletter distributed by DOH entitled "Water Tap" since 1992²¹ Each of these newsletters clearly provides information regarding eligible projects, eligible applicants, and interest rates as well as information regarding free workshops to discuss these topics.²² According to the information in "Water Tap" Iliad would be eligible for this source of funding. These newsletters also provide forms to obtain copies of the SRF guidelines.²³ The SRF guidelines describe, in significant detail, eligible applicants, projects and activities.²⁴ These guidelines substantiate that Iliad would be eligible for SRF financing.
- 16 Moreover, in April 2006, DOH affirmatively advised Iliad that low-interest loans were available and that more than a month remained to submit an application for such funding in 2006.²⁵ Although eligible, Iliad did not avail itself of the opportunity to apply for this funding in May 2006.
- 17 The second issue applicable to SRF financing is the nature of the project to be funded with the low-interest loan. DOH assigns priority to SRF funding requests.²⁶ That priority is based on the health risk that will be addressed in the proposed project.²⁷ The five risk categories are listed in priority order: Risk Category 1 is microbial; Risk Category 2 is primary inorganic chemical; Risk Category 3 is other primary chemical; Risk Category 4 is secondary chemical contaminant or sea water intrusion; and Risk Category 5 is infrastructure replacement or other distribution improvements.²⁸ DOH concluded that the chlorination project in this case would be classified as a Risk Category 1 because of existing or potential microbial contamination.²⁹ DOH further concluded that the chlorination project would most likely have been funded through

²⁰ Sarver, Exh. No. 64 at 13:19-20.

²¹ Sarver, Exh. Nos. 65 through 70 and TR. 46:20-25 and TR. 47:1-18..

²² Sarver, Exh. Nos. 65-70.

²³ *Id.*

²⁴ Sarver, Exh. No. 71.

²⁵ Pell, Exh. No. 60 at 1.

²⁶ Sarver, Exh. No. 64 at 16:16-22 and 17:1-2.

²⁷ *Id.*

²⁸ *Id.*

²⁹ Sarver, Exh. No. 64 at 17:20-22 and Dorland, Exh. No. 16 at 4.

the SRF because it is a Risk 1 Category and all eligible Risk Category 1, 2, and 3 projects were funded through the first ten years of the DWSRF program.³⁰

18 Thus, it appears that Iliad, as a privately-owned community water system, was eligible for SRF funding.³¹ In addition, the chlorination system installation would alleviate a microbial risk so the project would have been classified as a Risk 1 Category, the highest priority of funded projects.

19 The differential between the two forms of financing is significant. The disparity in interest rates between the financing Iliad obtained and the financing available from SRF is considerable. Iliad obtained financing at the rate of 11 percent³² while SRF funding is available for 1.5 percent.³³ To put the disparity in perspective, Iliad's financing on a comparable loan would be more than eight times more expensive than pursuing SRF financing.

20 Staff computed the present value amounts for both Iliad's form of financing and SRF financing, assuming 100 percent of the project was financed.³⁴ A company funding a project with an SRF loan does incur additional costs that a company may not incur with a private loan.³⁵ Thus, the amortized amount of the project is higher using SRF financing. An amortization schedule with a comparison of the present value of the two financing mechanisms is as follows:

AMORTIZATION SCHEDULE WITH PRESENT VALUE

Description	Interest Rate	Term	Amortized Amount	Present Value at 8%
Private Financing	11.0 %	10 yrs.	\$132,795	\$147,293 ³⁶
SRF Financing	1.5 %	20 yrs.	\$164,009	\$91,700 ³⁷

³⁰ Sarver, Exh. No. 64 at 18:13-19

³¹ Sarver Exh. No. 64 at 8:19-20.

³² Dorland, Exh. No. 6:2; Dorland, Exh. No. 15:2

³³ Sarver, Exh. Nos. 65-70.

³⁴ Kermod, Exh. No. 20 at 20:20-22 and at 21:1-4.

³⁵ Kermod, Exh. No. 20 at 20:3-6.

³⁶ Kermod, Exh. No. 28

³⁷ Kermod, Exh. No. 29

- 21 Staff supported using an SRF loan to finance this project. At the public hearing in Eatonville, 11 customers presented testimony.³⁸ Several of these customers expressed concern about the interest rate in the financing mechanism selected by Iliad.³⁹ These customers supported the use of an SRF loan to finance the chlorination system.⁴⁰
- 22 The SRF loan produces the lowest present value and thus is the optimal method of financing. Applying the traditional test for prudence to Iliad's financing decision, demonstrates that reasonable management would have decided in favor of SRF financing given that they either knew or reasonably should have known that the company was eligible for SRF funding and that the chlorination project would receive the highest priority for funding. Moreover, reasonable management would either have known or should have known that SRF financing produces the lowest present value. Iliad's failure to pursue SRF funding does not appear to be prudent financial planning.
- 23 The next component in evaluating the prudence of Iliad's financial planning is the timing of the collection of any assessment or surcharge. Iliad proposes to use the funds from these sources to commence construction.⁴¹ Small water companies are entitled to use a variety of funding mechanisms. One authorized mechanism is the collection of a surcharge from customers to fund a reserve for a future capital project or to service and repay debt used for financing current water utility plant.⁴² Installation of the chlorination system would qualify for a surcharge to fund a reserve for this capital project. From the limited financial information provided by Iliad, it is apparent that the only viable options to fund this project are either government-sponsored loans or the customers themselves.⁴³ Iliad has chosen to finance this project with high-cost debt and recover the cost of financing from the customers.⁴⁴
- 24 According to the Company's proposal, customers would pay either an assessment within 30 days of the effective date of the tariff or a monthly surcharge commencing

³⁸ Exhibit No. 74 offered by Iliad for cross-examination of Staff witness, Kermode, was missing one page that was in the original document. During the public hearing, Exhibit No. 82, the missing page, was admitted.

³⁹ Anderson, TR. 111:20-25; Anderson, TR. 113:22-23; Exh. No. 79; Rice, TR. 124:2-7; Rice, TR. 128:19-20; Howard, TR. 132:9-11; Pritchard, TR. 147:19-25; Rice, Exh. No. 77.

⁴⁰ *Id.*

⁴¹ Dorland, Exh. No. 1 at 8:22-23; Dorland, Exh. No. 17:2; and Kermode, Exh. No. 20 at 16:1-3.

⁴² Kermode, Exh. No. 20 at 14:9-16 and WAC 480-110-455.

⁴³ Staff Brief at 6, ¶13.

⁴⁴ *Id.*

with the next billing cycle.⁴⁵ After collection of either the assessment or commencement of the surcharge, Iliad would begin construction of the chlorination system.⁴⁶ Thus, Iliad will begin recovery of the cost of the system before the plant is either constructed or used and useful in providing utility service.⁴⁷

25 According to RCW 80.04.250, the fair valuation of utility property for ratemaking purposes is based on the property that is “used and useful” in providing utility service.⁴⁸ Normally, utility plant is placed in service prior to the collection of rates so that customers pay for the service they receive⁴⁹ The Commission has rarely permitted the collection of “Construction Work in Progress” (CWIP) and has noted its reluctance to do so.⁵⁰ If the assessment or surcharge is collected immediately, Iliad would begin recovery of CWIP before the plant is constructed or placed into service for the benefit of customers.⁵¹ Therefore, Staff recommended that an assessment or surcharge be collected only upon a showing by Iliad that the chlorination system is constructed and in service.⁵²

26 As noted in the “*prudence of construction planning*” section below, the need to construct the chlorination plant has been outstanding for approximately six years. However, construction of the utility plant at issue has not yet commenced. Iliad did not present evidence regarding when construction would begin or when the plant would be in service for its customers. Accordingly, Staff’s recommendation that any method to recover the costs of installing the chlorination plant be implemented after construction is complete and the plant is used and useful in providing utility service is reasonable. While a surcharge may be an appropriate financing vehicle in instances where a company has obtained reasonable cost financing and pursued construction within a reasonable period of time, that is not the case here. In this case, Iliad obtained high-cost financing despite the availability of a low-cost alternative and has not pursued construction for approximately six years. Considering both the source of financing and the timing of collection of any assessment or surcharge, Iliad’s proposal does not constitute prudent financial planning.

⁴⁵ Kermode, Exh. No. 20 at 16:15-20.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ Kermode, Exh. No. 20 at 17:1-4.

⁴⁹ *Id.*

⁵⁰ Kermode, Exh. No. 20 at 17:5-8.

⁵¹ Staff Brief at 24:¶55.

⁵² *Id.*

- 27 ***Prudence of Construction Planning:*** The history of this project is important for resolution of the issue of whether Iliad acted prudently in planning the construction of this project. Iliad owns three water systems including Alder Lake Water System.⁵³ The need to install a chlorination system for the Alder Lake system has been outstanding for approximately six years. The following is a chronology of the chlorination system project that is at issue in this proceeding.
- 28 In December 2000, Alder Lake Water System's water source ran out of water at a time when the water level of Alder Lake was low⁵⁴ The DOH concluded that the wells serving this water system were clearly in "hydraulic connection" to the body of water named Alder Lake and were vulnerable to contamination from surface water pathogens such as *Giardia* and *Cryptosporidium*.⁵⁵ As a result, the DOH required Iliad to take certain steps, including installing a chlorination system, to ensure that there were no contaminants in the water supply.⁵⁶
- 29 In February 2001, Iliad hired an engineer to prepare and submit a project report and construction document to DOH.⁵⁷ Those documents were submitted to DOH on May 30, 2001.⁵⁸ After review by DOH, the report and plan were revised and resubmitted on December 19, 2001.⁵⁹ On January 31, 2002, DOH approved the engineering report and construction documents.⁶⁰
- 30 In February 2002, Iliad sought financing for the project and obtained a commitment for financing from BHL Investments approximately one year later in January 2003.⁶¹ On August 9, 2004, Iliad issued an invitation to bid.⁶² Iliad selected the low bidder, Aerie Construction, with a construction bid of \$68,020.⁶³ The cost of the project was estimated to be \$116,700 including engineering and other costs.⁶⁴ The total cost for the project including legal, financing, and underwriting fees was \$125,972.⁶⁵ Iliad

⁵³ Kermode, Exh. No. 20 at 3:11-12.

⁵⁴ Dorland, Exh. No. 1 at 2:20-21.

⁵⁵ Pell, Exh. No. 35:2. *Giardia* infection or *giardiasis* and *cryptosporidiosis* are illnesses caused by waterborne parasites.

⁵⁶ *Id.* at 2:21-22; *id.* at 3: 6-8; and Dorland, Exh. No. 2.

⁵⁷ Dorland, Exh. No. 1 at 3:13-14.

⁵⁸ *Id.* at 3:14-15.

⁵⁹ *Id.* at 3:15-17.

⁶⁰ *Id.* at 4:2-3; and Exh. No. 3.

⁶¹ Dorland, Exh. No. 1 at 4: 7-8 and 12-13.

⁶² *Id.* at 5:2.

⁶³ Dorland, Exh. No. 4:1.

⁶⁴ Dorland, Exh. No. 1 at 5:15-17.

⁶⁵ *Id.* at 5:17-18.

filed a tariff revision with the Commission to fund the project on October 11, 2004.⁶⁶ Iliad responded to a number of Staff data requests and ultimately withdrew this filing on May 24, 2005. Iliad stated that it withdrew the tariff filing for several reasons.⁶⁷ First, it became apparent that the matter would proceed to hearing and Iliad felt that the hearing process would be too expensive to undertake.⁶⁸ In addition, Iliad wanted to investigate the availability of SRF financing and to issue a new invitation to bid for the project.⁶⁹

31 On December 2, 2005, Iliad released a second invitation to bid for installation of the chlorination system required by the DOH.⁷⁰ Iliad received three bids for the project and selected the lowest bidder.⁷¹ In 2006, Iliad confirmed the availability of financing with the lender on the original tariff filing. On March 1, 2006, Iliad refiled with the Commission for approval of a customer surcharge to finance the project.⁷²

32 The foregoing history of this project raises several concerns. First, the question arises as to why it has taken so many years for Iliad to undertake this project. Iliad stated that it is a small company with limited assets and had a difficult time obtaining financing.⁷³ While it appears realistic that it would take Iliad a more extended period of time to obtain financing than a larger corporation with more considerable assets, it is not reasonable to attribute a six year interval, most of which was delay, solely to the issue of obtaining financing. Iliad did not commence the process to obtain financing until more than a year after the DOH directed Iliad to undertake the project.⁷⁴ Yet another year expired before Iliad actually obtained a financing commitment.⁷⁵

33 Iliad either knew or should have known the approximate cost associated with the project when it submitted its project report and construction documents to DOH on May 30, 2001. However, Iliad appears to not even have commenced the process to obtain financing until approximately nine months after that submission to the DOH. At this juncture, approximately two years had already expired since Iliad was directed to install the chlorination system.

⁶⁶ *Id.* at 6: 3.

⁶⁷ *Id.* at 8:6-12,

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ Dorland, Exh. No. 14 at 3-5.

⁷¹ *Id.* at 14:7-12.

⁷² Dorland, Exh. No. 1 at 8:22-23.

⁷³ Dorland, Exh. No. 1 at 4:16-18.

⁷⁴ In December 2000, DOH directed Iliad to take certain action and Iliad did not seek financing until February 2002. *See* n. 9 and 15.

- 34 A second factor contributing to the delay in commencing construction of the project was the length of time Iliad took to obtain construction bids. While Iliad had the DOH approval for its project plans in January 2002, Iliad did not put the project out for bid until August 9, 2004, approximately 19 months later.⁷⁶ Iliad explained that it had a number of projects to undertake in the interim and could not address all the projects at the same time.⁷⁷ With a small water company, that is certainly a logical and reasonable approach. However, Iliad did not provide any evidence regarding the nature of the other projects undertaken in this time period and one would assume that a project that presented potential public health risks to consumers would receive the highest priority. Regrettably, that does not appear to be the case.
- 35 A third factor contributing to the delay was the failure to seek Commission approval in a timely manner. On October 11, 2004, Iliad filed its first tariff revision for approval of the surcharge to fund the chlorination system.⁷⁸ That is an important date because while Iliad advised DOH as early as August 22, 2003, that it had submitted paperwork to the Commission and that the Commission requested more documentation of the costs, no tariff filing was pending before the Commission in August 2003.⁷⁹ In fact, the initial tariff filing was not submitted until more than one year later.⁸⁰
- 36 In another communication with the DOH on September 29, 2003, Iliad represented that it expected Commission approval of its fee structure by the end of 2003.⁸¹ However, it is difficult to ascertain what the Commission could have approved because no tariff filing was pending approval. To reiterate, the first tariff filing was not submitted until October 2004.
- 37 In a letter from DOH to Iliad dated May 21, 2004, DOH stated that “[A]ccording to our records, you have been making application to WUTC for upgrade to this system since December 12, 2001, in response to the same requirement.”⁸² The requirement referenced in this quote is the requirement to provide disinfection of the water system;

⁷⁵ See n. 16.

⁷⁶ See n. 17.

⁷⁷ Dorland, Exh. No. 1 at 5:4-9.

⁷⁸ Kermode, TR. 70:2-5

⁷⁹ During cross-examination, Staff did not recall any informal discussions with Iliad prior to the initial tariff filing, TR. 73:24-25 and TR. 74:1-3.

⁸⁰ Pell, Exh. No. 47; Kermode, TR. 70:20-25 and Kermode, TR. 71:1-15.

⁸¹ Pell, Exh. No. 50.

⁸² Pell, Exh. No. 55.

a requirement DOH imposed January 18, 2001.⁸³ In the same letter, DOH states that “[T]he improvements are long overdue.”⁸⁴ That letter predates any tariff filing with the Commission by approximately five months. Even more egregious, the letter contains the representation that Iliad had been seeking Commission approval since 2001. In fact, Iliad did not seek Commission approval in 2001, 2002, or 2003. The first tariff revision was not submitted until 2004.⁸⁵ And, while DOH concluded the improvements were long overdue in 2004, another two and one-half additional years have transpired without implementation of the improvements.

38 It is difficult to ascertain what Iliad could gain from these representations documented by DOH other than delay in implementing DOH’s directive. Presumably, if DOH thought Iliad was awaiting action from another state agency, the Commission, it would defer enforcement of the installation of chlorination system requirement. That deferral was, naturally, for an indeterminate amount of time because Iliad had not requested any action from the Commission. However, delay in implementing DOH’s directive did not serve the best interest of Iliad’s customers. Absent the chlorination system required by DOH, Iliad’s customers were exposed to significant potential health risk. If Iliad had simply taken the action it represented to DOH that it had; that is, seek approval for the financing of the project, both the utility and its consumers could have benefited from a more expeditious resolution of this issue.

39 Moreover, once Iliad finally sought Commission approval, it submitted two sequential filings further exacerbating the delay. The first tariff revision was filed on October 11, 2004, almost four years after DOH directed Iliad to install the chlorination system.⁸⁶ Moreover, almost three years expired between DOH approval of the project plans and the filing of the first tariff revision. In addition, Iliad secured a financing commitment almost two years before it filed its first tariff revision. Analyzing the time periods between each action taken by Iliad, it is apparent that the delay is excessive. Because the potential for a serious public health issue was the genesis for the project, reasonable management would have expended efforts to obtain Commission approval of the tariff revision as expeditiously as possible. Iliad’s failure to undertake this project in a timely manner does not appear to have been a prudent course of action.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ Kermode, TR. 72:17-25 and Kermode, TR. 73:1-3.

⁸⁶ *See* n. 18.

40 On May 24, 2005, Iliad withdrew its initial filing with the Commission to, among other things, investigate SRF financing for the project.⁸⁷ The tariff revision that is the subject of this case was filed on March 1, 2006. However, as previously discussed, it does not appear that Iliad undertook a reasonable investigation of the availability of SRF funding during the interval between the two tariff filings.

41 The now endemic delay in undertaking this project demonstrates that there was not prudent planning for the construction of this project for several reasons. Again, the traditional test for prudence must be applied to determine what reasonable company management would have decided given what they knew or should have known. First and foremost, Iliad was directed to install the chlorination system because of the health risks present for consumers. Iliad was advised as early as December 19, 2000, that “[T]he wells serving the Alder Lake water system are clearly in ‘hydraulic connection’ to Alder Lake and are vulnerable to contamination from surface water pathogens such as *Giardia* and *Cryptosporidium*.”⁸⁸ Iliad admitted the health risk posed to consumers because it noted that “[T]he summers of 2004 and again in 2005 the Water Company experienced continual positive bacteria sampling placing the water customers at risk.”⁸⁹ Reasonable company management knew or should have known that the installation of the chlorination system in question in this filing would remedy the potential for serious health risk present in the water system. However, Iliad has yet to commence construction of the chlorination system and did not submit the current tariff filing until March 2006.

42 On April 11, 2006, in response to Staff data requests in conjunction with this tariff revision, Iliad asserted that “[T]ime is of the essence to install the Chlorine Disinfection System.”⁹⁰ Iliad’s apparent concern with installing the chlorination system expeditiously is perplexing in light of the fact that DOH required installation of this system approximately six years ago but construction has yet to commence. Of note is the fact that Alder Lake water customers have been exposed to water that presents a potential health risk during this entire time period and that continues to date. Prudent management would have undertaken installation of the chlorination system shortly after being required to do so by the DOH

⁸⁷ See n. 19.

⁸⁸ Dorland, Exh. No. 2:2.

⁸⁹ Dorland, Exh. No. 16:4.

⁹⁰ *Id.*

- 43 ***Reasonableness of Project Costs:*** As discussed previously, the central issue in evaluation of the project costs is the cost associated with financing and Iliad failed to meet its burden of proof that the proposed financing cost is reasonable.
- 44 A second component of the project cost is the construction cost itself. Iliad issued its current invitation for bids on December 2, 2005.⁹¹ Iliad received three bids.⁹² Iliad, Inc. was the low bidder for the project.⁹³ Iliad, Inc. has a contract to perform maintenance services for Iliad.⁹⁴ Iliad, Inc. was also involved in the issuance of the invitation to bid.⁹⁵ Iliad, Inc. received the bids submitted on the project.⁹⁶ Although there is no common corporate structure, the two corporations employ some of the same personnel.⁹⁷ For example, the President of Iliad is also the superintendent of Iliad, Inc.⁹⁸ The fact that the entity issuing the invitation to bid and reviewing the bids is ultimately the same entity awarded the contract warrants close scrutiny. Upon examination, the successful bidder does remain the low bidder for the project by approximately \$4,288 to \$18,045.⁹⁹ Moreover, the bid submitted by Iliad, Inc., is dated one day before other two bids.¹⁰⁰ Considering the magnitude of difference between Iliad, Inc.'s bid and the other bidders as well as the date of the bid, there is no evidence to indicate that the bid is improper.
- 45 A bid process where the maintenance services contractor for the utility issues the invitation to bid, reviews the bids, and awards itself the project as the lowest bidder may raise questions regarding the propriety of the process. Therefore, for future projects, Iliad should consider employing the assistance of an independent third party to manage the bid process.
- 46 While there is no evidence to indicate that the current bid is improper, a comparison between the amount of the current low bid and the amount of low bid submitted by Aerie Construction with the 2004 tariff revision, the bid does not fare so favorably. The current bid from Iliad, Inc., is \$108,164.¹⁰¹ The bid from Aerie Construction in

⁹¹ Dorland, Exh. No. 14:3.

⁹² *Id.* at 7-12.

⁹³ Dorland, TR. 28:1-3.

⁹⁴ Dorland, TR. 28:1314; TR. 39:15-16.

⁹⁵ Dorland, TR. 28:9-10.

⁹⁶ Dorland, TR. 28:21-23.

⁹⁷ Dorland, TR. 39:13-20; Dorland, TR. 38:20-23.

⁹⁸ Dorland, TR. 38:20-24 and Dorland, TR. 39:1-3; Dorland, TR. 26:24-25 and Dorland, TR. 27:1.

⁹⁹ Dorland, Exh. No. 14 at 7-12.

¹⁰⁰ *Id.*

¹⁰¹ Kermode, Exh. No. 20 at 11:5.

2004 was \$68,020.¹⁰² Thus, the current bid represents a 59 percent increase to install the chlorination system.¹⁰³ The comparison between the low bids in the two tariff revisions becomes even more dramatic when two additional factors are considered; the date of the bids and the scope of the work. With respect to the date of the bids, the successful bid from Aerie Construction, Inc., included with the initial tariff revision is dated August 23, 2004.¹⁰⁴ The successful bid accompanying this tariff revision is dated December 15, 2005.¹⁰⁵ Thus, the bids are only separated by approximately 16 months. The passage of time does not account for a 59 percent increase in costs. Second, the scope of work in the bid submitted by Aerie Construction, Inc., included the cost of 35 water service connections that are not included in the current bid.¹⁰⁶ Iliad did not provide any clear explanation for the significant difference in the bids.¹⁰⁷

47 Staff proposed excluding three items included in Iliad's construction cost estimate.¹⁰⁸ Specifically, the items entitled "Engineering", "DOH Review Fee," and "MPA Tests"¹⁰⁹ equaling \$11,896.¹¹⁰ Staff argued that these costs were already incurred and should be recovered as normal investment over the life of the associated asset in the Iliad's basic water service rate, not in a surcharge or special assessment.¹¹¹ Staff also opposed Iliad's characterization that these were "Approved as construction costs by the WUTC"¹¹² because these costs have not been previously submitted to the Commission and have not been approved.¹¹³

48 With the exception of the financing costs associated with the project, the construction costs do not appear to be unreasonable provided the prior costs are deducted from the surcharge or assessment, capitalized, and recovered over the average life of the plant.

49 ***Motion to Reopen Record:*** On December 27, 2006, Iliad filed a motion to accept late-filed exhibit. Iliad requested that an affidavit from Iliad's engineer be accepted after the evidentiary record in this matter closed. Staff opposed the motion.

¹⁰² Kermode, Exh. No. 20 at 11:10-11.

¹⁰³ Kermode, Exh. No. 20 at 10-12.

¹⁰⁴ Dorland, Exh. No. 4 at 1.

¹⁰⁵ Dorland, Exh. No. 14 at 7-8.

¹⁰⁶ Kermode, Exh. No. 20 at 11:12-14.

¹⁰⁷ Dorland, Exh. No. 14 at 7; Kermode, Exh. No. 20 at 11:11-14

¹⁰⁸ Kermode, Exh. No. 20 at 12:3-7.

¹⁰⁹ Microscopic Particulate Analysis.

¹¹⁰ Dorland, Exh. No. 14:13; Kermode, Exh. No. 20 at 12:3-7.

¹¹¹ Kermode, Exh. No. 20 at 12:22-23 and 13:1-5.

¹¹² Dorland, Exh. No. 14 at 13.

¹¹³ Kermode, Exh.

- 50 Based on the nature of the relief requested, Iliad's motion is a motion to reopen the record. According to WAC 480-07-830, the Commission may reopen the record in contested proceedings to allow the receipt of written evidence if the following standard is met: (1) the evidence is essential to a decision; and (2) the evidence was not unavailable at the time of hearing; and (3) the evidence was not reasonably discoverable with due diligence at the time of hearing; or (4) for any other good and sufficient cause.
- 51 Iliad failed to meet the standard in the regulation. First, the evidence is not essential to a decision. As noted by Iliad, the document addresses the reputation of Iliad's engineer. That is not an issue within the purview of this proceeding. Moreover, as stated in the body of this Order, the credibility of Iliad's engineer was not determinative of any issue in this decision. Second, the exhibit was available at the time of hearing. In fact, the exhibit that Iliad now seeks to rebut, Exhibit 73, was submitted with the prefiled responsive testimony of Richard Sarver on October 4, 2006. This would have been an appropriate topic to have addressed in reply testimony. Iliad filed reply testimony on November 2, 2006, but did not include the document it now seeks to have considered. Iliad did not introduce the document as a cross-examination exhibit. Third, the discoverability of this document is not at issue because this is a document generated by Iliad. Finally, Iliad did not state other good and sufficient cause why this issue was not addressed in either prefiled testimony or during the evidentiary hearing. Accordingly, the motion to reopen the record is denied.
- 52 **Conclusion:** Iliad failed to meet its burden of proof that the proposed tariff revision is just, reasonable, and sufficient. Accordingly, the request for approval of the tariff revision should be rejected.

FINDINGS OF FACT

- 53 Having discussed above all matters material to the Commission's decision and having stated general findings, the Commission now makes the following summary findings of fact. Those portions of the preceding discussion that include findings pertaining to the Commission's ultimate decisions are incorporated by this reference.

- 54 1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate the rates and charges of water companies.
- 55 (2) Iliad Water Services, Inc., is a water company owning, controlling, operating, or managing a water system for hire within the State of Washington that is subject to regulation by the Commission.
- 56 (3) In December 2000, the Department of Health concluded that the wells serving this water system were vulnerable to contamination from surface water pathogens such as *Giardia* and *Cryptosporidium* and required Iliad Water Services, Inc., to take certain steps including installing a chlorination system.
- 57 (4) On March 1, 2006, Iliad Water Services, Inc., filed a tariff revision to fund the installation of the water chlorination system required by the Department of Health.
- 58 (4) Iliad Water Services, Inc., obtained a financing commitment for this project at the rate of 11 percent for 10 years.
- 59 (5) Iliad Water Services, Inc., failed to pursue Drinking Water State Revolving Fund financing at the rate of 1.5 percent.
- 60 (6) The method of financing the project selected by Iliad Water Services, Inc., is more than eight times more expensive than Drinking Water State Revolving Fund financing.
- 61 (7) Iliad Water Services, Inc., proposed to collect a surcharge from its customers to finance the project before the chlorination system is installed.
- 62 (8) Iliad Water Services, Inc., obtained approval from the Department of Health for its engineering report and construction documents on January 31, 2002.
- 63 (9) Iliad Water Services, Inc., delayed the process of seeking financing for the project for more than a year after December 2000 when the Department of Health directed it to take certain action.

- 64 (10) Iliad Water Services, Inc., did not obtain a financing commitment until January 2003.
- 65 (11) Iliad Water Services, Inc., issued an invitation to bid for construction of the project on August 9, 2004, approximately 19 months after obtaining Department of Health approval for the project.
- 66 (12) Iliad Water Services, Inc., represented to the Department of Health that it applied to the Washington Utilities and Transportation Commission for approval of its fee structure on or about December 12, 2001.
- 67 (13) Iliad Water Services, Inc., filed its first tariff revision with the Washington Utilities and Transportation Commission on October 11, 2004, almost three years after it represented to the Department of Health that it had filed such an application and almost four years after the Department of Health directed Iliad Water Services, Inc., to install the chlorination system.
- 68 (14) On May 24, 2005, Iliad Water Services, Inc., withdrew its first tariff filing to, *inter alia*, investigate Drinking Water State Revolving Fund financing and issue a new invitation to bid the construction of the project.
- 69 (15) On December 2, 2005, approximately seven months after it withdrew its initial tariff filing, Iliad Water Services, Inc., issued a second invitation to bid for construction of the project.
- 70 (16) The current low bid for the project was received on December 15, 2005.
- 71 (17) Iliad Water Services, Inc., received the first successful bid for the project on August 23, 2004, and the second successful bid for the project on December 15, 2005, approximately 16 months later.
- 72 (18) The scope of the project for the second bid is less than the first bid because the second bid does not include the installation of 35 water service connections.
- 73 (19) The current successful bid is approximately 59 percent higher than the first bid.

- 74 (20) Iliad Water Services, Inc., filed its second tariff revision with the Washington Utilities and Transportation Commission, on March 1, 2006, more than five years after the Department of Health directed installation of the chlorination system.
- 75 (21) More than six years after directed to do so by the Department of Health, Iliad Water Services, Inc., has not commenced construction of the chlorination system.
- 76 (22) The document submitted by Iliad Water Services, Inc., as a proposed late-filed exhibit is not essential to any decision in this proceeding.
- 77 (23) The document presented by Iliad Water Services, Inc., either did, or could have existed in October 2006.
- 78 (24) Iliad Water Services, Inc., failed to include the document as an exhibit to its prefiled reply testimony on November 2, 2006.
- 79 (25) Iliad Water Services, Inc., failed to identify the document as a cross-examination exhibit.
- 80 (26) Iliad Water Services, Inc., generated the document so the discoverability of the document is not at issue.
- 81 (27) Iliad Water Services, Inc., did not present any other good and sufficient cause to reopen the record in this proceeding.

CONCLUSIONS OF LAW

- 82 Having discussed above in detail all matters material to the Commission's decision, and having stated general findings and conclusions, the Commission now makes the following summary conclusions of law. Those portions of the preceding detailed discussion that state conclusions pertaining to the Commission's ultimate decisions are incorporated by this reference.
- 83 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, these proceedings, according to RCW

80.04.010, RCW 80.04.130, RCW 80.04.250, RCW 80.28.020, and RCW 80.28.022.

- 84 (2) Iliad Water Services, Inc., failed to meet its burden of proof that the proposed tariff revision results in rates or charges that are just, reasonable, and sufficient, as required by RCW 80.28.020.
- 85 (3) Iliad Water Services, Inc., failed to meet the standard in WAC 480-07-830 to reopen the record in this proceeding to receive a late-filed exhibit.

ORDER

THE COMMISSION ORDERS That

- 86 (1) The request for approval of a tariff revision to fund a water chlorination system filed by Iliad Water Services, Inc., is rejected.
- 87 (2) The motion to reopen the record filed by Iliad Water Services, Inc., is denied.

Dated at Olympia, Washington, and effective January 10, 2007.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

PATRICIA CLARK
Administrative Law Judge

NOTICE TO THE PARTIES

This is an Initial Order. The action proposed in this Initial Order is not yet effective. If you disagree with this Initial Order and want the Commission to consider your comments, you must take specific action within the time limits outlined below. If you agree with this Initial Order, and you would like the order to become final before the time limits expire, you may send a letter to the Commission, waiving your right to petition for administrative review.

The time for filing a *Petition for Administrative Review* and any *Answer* thereto will be established, after consultation with the parties, by subsequent notice. What must be included in any Petition and other requirements for a Petition are stated in WAC 480-07-825(3).

WAC 480-07-830 provides that before entry of a Final Order any party may file a Petition to Reopen a contested proceeding to permit receipt of evidence essential to a decision, but unavailable and not reasonably discoverable at the time of hearing, or for other good and sufficient cause. No Answer to a Petition To Reopen will be accepted for filing absent express notice by the Commission calling for such answer.

RCW 80.01.060(3), as amended in the 2006 legislative session, provides that an Initial Order will become final without further Commission action if no party seeks administrative review of the Initial Order and if the Commission does not exercise administrative review on its own motion. You will be notified if this order becomes final.

One copy of any Petition or Answer filed must be served on each party of record with proof of service as required by WAC 480-07-150(8) and (9). An original and eight copies of any Petition or Answer must be filed by mail delivery to:

Attn: Carole J. Washburn, Executive Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, Washington 98504-7250