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BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

ILIAD WATER SERVICES, INC.,

Respondent.

DOCKET UW-060343

PETITION FOR REVIEW AND STATEMENT
OF POSITION

Iliad Water Services, Inc. ("Iliad") hereby submits its Petition for Review and also includes its Statement of Position on the questions contained in the Commission's Order setting forth the Notice of Possible Discretionary Review dated January 12, 2007.

BACKGROUND

This Petition for Administrative Review will be somewhat unusual in its presentation for at least two reasons. The first is the position that Iliad finds itself in as a result of this proceeding and the Washington State Department of Health ("DOH") Order requiring construction of improvements for the

1 Alder Lake system, which are the subject of the tariff filing in this matter, to be completed by March 30,
2 2007.¹ The second is the very limited resources of this company.²

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4 OVERVIEW OF ILIAD'S VIEW OF THE INITIAL ORDER

5 The Initial Order essentially does three things. It criticizes the company for moving too slowly.
6 It concludes that the company's choice of financing of the project was imprudent. And, it concludes that
7 the size and cost of the project is not imprudent.
8

9 There are a number of factual aspects of the Initial Order that Iliad believes to be in error.
10 However, rather than a point-by-point examination of the Initial Order, Iliad believes it is more
11 productive to focus on the bottom line of this proceeding.

12 However, Iliad does want the Commission to understand that on the issue of timeliness, Iliad
13 agrees, in retrospect, that it should have moved faster. At the time, Iliad did not realize that it was
14 moving slowly. Given the size of the company and the number of things to do, it just did not seem that
15 way at the time.
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17 Iliad now recognizes that once the design for the improvements was approved by DOH, it should
18 have been more aggressive in obtaining financing. In addition, once financing was obtained, Iliad
19 should have been more aggressive obtaining bids and in making its filing with the Commission.
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25 ¹ Exhibit 61, p. 5.

26 ² Exhibit 75, p. 6.

1 CONTEXT

2 This is the situation before the Commission. DOH has issued an order that requires construction
3 of the improvements by March 30, 2007.³ Alder Lake is a very small system with approximately thirty-
4 nine customers.⁴ Iliad serves three water systems with a total of eighty-nine customers.⁵ The
5 company's total operating revenue for 2005 was \$24,390.00.⁶ The company had an operating loss in
6 2005 of \$23,321.00.⁷ When interest expense is included, the company had a net loss of \$46, 252.00 in
7 2005.⁸ The company has total assets of \$90,000.00.⁹ The project costs for construction of the treatment
8 facilities will exceed \$100,000.00.¹⁰

9
10 Commission Staff recommended that the company seek funding from the State Drinking Water
11 Revolving Fund.¹¹ However, the next cycle for funding does not occur until May, 2007. As Exhibit 71
12 demonstrates, which are the instructions for applying for a loan from the State Drinking Water
13 Revolving Fund, past costs, that is, costs incurred for construction prior to loan approval, are not eligible
14 for reimbursement.¹² Thus, if the company constructs the project prior to a State Drinking Water
15 Revolving Fund application being approved, it cannot receive reimbursement from that program for
16 those construction costs.
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21 ³ Exhibit 61, p. 5.

22 ⁴ Exhibit 20, p. 10, l. 6.

23 ⁵ Exhibit 75, p. 6; Exhibit 20, p. 3.

24 ⁶ Exhibit 75, p. 6.

25 ⁷ Ibid.

26 ⁸ Ibid.

⁹ Exhibit 20, p. 7, l. 18-20.

¹⁰ Initial Order at ¶46.

¹¹ Exhibit 20, p. 17, l. 17-22.

¹² Exhibit 71, p. 4 (labeled as p. 1 on the Exhibit) ("Loan draws are reimbursement only for eligible projects made after loan agreement execution").

1 PROPOSAL

2 One of the wisest judges to grace the Thurston County bench was Judge Robert Doran. Amidst
3 the clutter of competing facts and legal arguments, Judge Doran would from time to time remind
4 counsel that what the court was seeking was justice as best it could be found for the matter before the
5 court. In the lexicon of the Commission, this is a result that is "fair, just and reasonable." This means a
6 result that will serve the customers' needs and the company's ability to provide services to meet those
7 customers' needs.
8

9 In this case, the Department of Health has stated that the customers need to have treatment
10 facilities constructed. The company is without the resources to perform that function without some sort
11 of outside financing.¹³

12 Commission Staff and the Initial Order believe that the best source of financing is the State
13 Drinking Water Revolving Fund. However, the next round of funding is not available until May, 2007.
14 As a means of addressing this situation, Iliad proposes that the Commission hold this case open until
15 after the next round of financing from the State Drinking Water Revolving Fund. If Iliad's application is
16 granted, then the amount of surcharge can be recalculated based upon that funding source.¹⁴ Iliad is
17 certainly willing to extend the suspension date to accommodate this proposal.
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24 ¹³ Commission Staff agrees. See, Exhibit 20, p. 7, l. 20-21 ("The only viable option for financing [the project] is either
through government sponsored loan programs or the customers themselves"). Indeed, Staff originally supported, although
reluctantly, the company's filing. See, Exhibit 74.

25 ¹⁴ Iliad has requested that DOH amend the construction date in the DOH Order to allow for the next State Drinking Water
26 Revolving Fund cycle. The pending request is verbal. A written request will be filed shortly. A response is still pending.

1 If, for some reason, Iliad does not qualify for State Drinking Water Revolving Fund financing,
2 then the commercial financing should be allowed to go into effect and the surcharge calculated
3 accordingly.¹⁵

4 The construction costs for the facilities would be capped at the amount that the Initial Order
5 found to be prudent. It appears that these costs are the amount of the winning bid of \$108,164, plus the
6 additional engineering and legal costs supported (as an alternative) by Staff.¹⁶ If construction costs
7 come in at lower than that level of costs, then an adjustment would be made to the surcharge. If the
8 costs come in at a higher level, then that is the company's risk. The underwriting and financing costs
9 would be calculated at the level in the State Drinking Water Revolving Fund. This would produce a
10 total cost somewhat less than the \$125,000 contained in Staff Exhibit 31.¹⁷ Further, the surcharge would
11 be spread over the twenty year life of the state loan as opposed to the ten year life of the commercial
12 loan. Further, the customers would retain the option of paying an amount up front, which would allow
13 them to avoid the financing costs altogether.

14 Iliad respectfully submits that this proposal makes sense and results in a conclusion for this
15 docket that is fair, just and reasonable. This proposal does not insulate Iliad from all risk. The amounts
16 that have previously been expended by Iliad of \$11,896¹⁸ that were not included in the amount found to
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23 ¹⁵ In the alternative, Iliad asserts the Initial Order errs in concluding that the use of commercial financing is imprudent and
seeks review of that conclusion and supporting findings.

24 ¹⁶ See, Initial Order at ¶46 and Exhibit 31.

25 ¹⁷ As an alternative, during the course of the proceeding, the company offered to cap the project costs at \$118,000.00. The
company stands by that offer.

26 ¹⁸ This is the engineering expense and is the figure from the Initial Order. The total, including testing and pre-construction
expense is approximately \$31,000.00. This is the amount that would be at issue in a general rate case.

1 be appropriate in the Initial Order¹⁹ would need to be submitted by Iliad for inclusion in a general rate
2 case to be recovered and would be examined at that time. There is no guarantee that those funds would
3 ultimately be allowed. Further, Iliad has had to expend thousands of dollars for this proceeding. It is
4 not clear how those funds would be recovered, but most certainly would have to be proposed for
5 recovery in a general rate case. Iliad's expenditures on this case in the amount of \$5,503.00²⁰ is a very
6 significant portion of its annual revenue of \$24,000.00.
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8 THE ISSUE OF IMPRUDENCE IN THE CHOICE OF FINANCING MECHANISM

9 If the Commission does not want to accept Iliad's proposal set out above, then Iliad seeks review
10 of the Initial Order. The Initial Order concludes that Iliad was imprudent by using private financing.²¹
11 The Initial Order concludes that Iliad should have early on sought financing through the State Drinking
12 Water Revolving Fund.²²
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14 Iliad respectfully disagrees with the conclusion in the Initial Order. Iliad relied on the advice of
15 its outside engineer that Iliad was not eligible for State Drinking Water Revolving Funds for the Alder
16 Lake project.²³ Factually, Iliad's engineer was wrong in his advice.
17

18 The Initial Order points to the fact that there were DOH publications that were read by Iliad's
19 officers that upon reflection should have informed Iliad that State Drinking Water Revolving Funds
20 were available for such a project and the company should have done the investigation itself.²⁴ However,
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23 ¹⁹ Initial Order at ¶47.

²⁰ This amount is for calendar year 2006 and does not include amounts associated with the tariff filing in 2004 or this Petition for Review.

²¹ See, Initial Order discussion at ¶¶12-26.

²² Initial Order at ¶22.

²³ Exhibit 1, p. 8, l. 15-17.

²⁴ Initial Order at ¶14.

1 that is like asking a company "Have you read DOH regulations?" and expect the company to know the
2 ultimate meaning of each and every regulation. Every small utility relies on outside consultants, be they
3 attorneys or engineers, to help them understand state regulations and processes.

4 The Initial Order sets a dangerous bar for finding of imprudence. Consider the ramifications: if
5 the Commission in a telecommunications arbitration issues a decision that relies on the technical advice
6 of a Commission Staff engineer as to how the telecommunications network is put together, and that
7 engineer is factually wrong, has the Commission been imprudent? If the Commission stakes out a
8 course of action relying on the advice of an Assistant Attorney General as to the proper meaning of a
9 statute and that attorney is wrong, has the Commission acted imprudently?
10

11 Utilities, and, in particular, small utilities, must be able to rely on the advice they receive from
12 outside professionals. They do not have the resources to seek second opinions. They do not have the
13 people or the time to be able to address every issue on their own.
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15 STATEMENT OF POSITION 16

17 The Notice of Possible Discretionary Review indicated that the Commission would accept
18 statements of position on two questions. Iliad will offer its statement of position on each of those two
19 questions.

20 Question 1: If an order rejects a tariff proposal because the evidence fails to support the full rates
21 requested, and an opponent opposes any rate increase at all, when, if ever, should the order identify a
22 level that the presiding officer believes is supported by the evidence?
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24 Iliad believes that the response depends upon the context of the particular case. Small water
25 companies need as much guidance as possible as to what matters are or are not acceptable. What may
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1 not be appropriate for Puget Sound Energy may be very appropriate for a small water company with
2 very limited resources.

3 The tools of traditional regulation present very rough results for small utilities, such as small
4 water companies. A crude analogy is that applying traditional regulatory tools to a small water company
5 is like working on a watch with a sledgehammer.

6 This case illustrates the types of Hobbesian choice that a small company must make. In this
7 docket, as an illustration, the case presented against the company included a voluminous parade of
8 exhibits. The company clearly did not have the resources to be able to analyze and refute the exhibits on
9 a page-by-page basis. The company had to make a choice as to what it believed was the most effective
10 response possible with very limited resources.

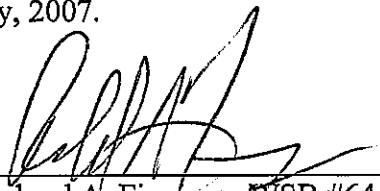
11 In this case, the underlying reason why the Initial Order rejected the tariff proposal on the basis
12 that the evidence failed to support the full rates requested was because of the finding of imprudence
13 related to the financing mechanism chosen by the company. The Initial Order was helpful by going on
14 to determine the amount of the surcharge, other than financing cost, that the presiding officer believed
15 was supported by the evidence before her. Thus, if the finding of imprudence on the choice of financing
16 is overturned, the parties need not then return to the record and have yet another evidentiary proceeding
17 related to the level of the cost of the project. That saves the company considerable expense. It preserves
18 the resources of the Commission. It seems that in this case it is an appropriate mechanism under which
19 the docket can proceed to subsequent levels without requiring a return to a prior stage of the proceeding
20 and using up the resources of both the Commission and the company.

21 Question 2: Does the record support the need for contributions in aid of construction in lieu of rate base
22 recognition of the asset after completion?
23

1 Yes. Commission Staff agrees that the company lacks the financial ability to fund this project
2 with internally-generated funds.²⁵ The company's financial records are in the record which
3 demonstrates the company's lack of resources.²⁶

4 Traditional rate-base/rate-of-return regulation, with asset lives likely to be in the range of thirty
5 years or more, would not produce sufficient revenues to be able to meet loan payments of either a
6 commercially-financed loan of ten years or even a State Drinking Water Revolving Fund loan, which
7 would be twenty years as opposed to asset lives of approximately thirty years. Given the company's
8 limited resources, this would mean that principal and interest payments on the loan would interfere with
9 the company's ability to provide service to the customers if recovery of the investment in the assets were
10 through a traditional rate-base/rate-of-return formula. A surcharge appears to be the only viable choice.
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13 Respectfully submitted this 22nd day of January, 2007.

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17 Richard A. Finnigan, WSB #6443
18 Attorney for Iliad Water Services, Inc.

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25 ²⁵ Exhibit 20, p. 7, l. 18-21.
26 ²⁶ Exhibit 75.