

Agenda Date: July 10, 2008
Item Number: A1

Docket: UW-080926
Company Name: Aquarius Utilities, LLC

Staff: Chris Mickelson, Regulatory Analyst
Dennis Shutler, Consumer Affairs Specialist

Recommendation

1. Issue a Complaint and Order Suspending the Tariff Revisions filed by Aquarius Utilities, LLC; and
2. Allow temporary rates at the staff recommended revised rates to become effective July 14, 2008, on less than statutory notice, subject to refund.

Discussion

On May 23, 2008, Aquarius Utilities, LLC, (Aquarius or company), filed with the Utilities and Transportation Commission (commission) tariff revisions that would generate \$106,055 (24.7 percent) in additional revenue per year. The company serves 880 customers located in Clallam, Kitsap and Mason counties. The proposed rates are prompted by increases in labor, benefits, insurance and new plant (pumps and pipes) costs. The company's last general rate increase became effective on March 14, 2002.

Staff's review of the company's operations and financial records indicated that the company's proposed rates filed on May 23, 2008, were excessive. Staff and the company reviewed the company's original filing and agreed to a revised revenue requirement and a revised rate design. On July 1, 2008, the company filed revised rates at the staff recommended level that would generate \$31,584 (7.3 percent) additional revenue per year. The company's original customer notice of March 31, 2008, did not contain the revised rate design and, as a result, the company is petitioning the commission for an exemption from WAC 480-110-425 to allow the new rate design to go in effect with the revised rates at staff recommended levels on less than statutory notice.

Customer Comments

On March 23, 2008, the company notified its customers of the rate increase by mail. The commission has received 94 customer comments to this filing. Staff's summary of the comments received with staff's response is attached.

The company agreed to a lower revenue requirement and staff's recommended revised rate design. Staff's revised rate design is significantly different from the company's original proposal to customers. Staff's revised rate design adjusts the water usage blocks, increases usage rates in each usage block, adds separate rate schedules for meters that are larger than three-fourths of an

inch, increases the rate for ready-to-serve customers to equal the base charge, and decreases the rate for the base charge.

The average customer, using 566 cubic feet of water, would pay \$42.80 using the revised rate design instead of \$50.27 using the original proposed rate design. Other customers (high usage metered customers) would pay higher bills using the revised rate design.

Customers have not had the opportunity to comment on the revised rates and rate design. Customers deserve to know about, and comment on, the revised rates and rate design. The commission should consider all information, including any additional customer comments on the revised rates and rate design, in deciding whether to approve the revised rates and rate design.

Rate Comparison

Monthly Rate	Current Rate	Proposed Rate	Revised Rate
Flat Rate (Unmetered)	\$43.55	\$50.50	\$50.50
Ready-to-Serve (RTS)	\$19.85	\$24.85	\$22.05
Base Rate (¾-inch meter)	\$30.95	\$35.95	\$22.05
Base Rate (1-inch meter)	\$49.01	\$56.93	\$36.82
Base Rate (1 1/2-inch meter)	\$93.74	\$108.93	\$73.43
Base Rate (2-inch meter)	\$147.64	\$171.56	\$117.53
0 – 500 cubic feet	\$2.00	\$2.50	\$3.55
501 – 900 cubic feet	\$2.00	\$2.75	\$4.55
901 – 1,000 cubic feet	\$2.00	\$2.75	\$5.55
1,001 – 1,600 cubic feet	\$3.00	\$3.00	\$5.55
1,601 – 2,000 cubic feet	\$3.00	\$3.00	\$7.85
Over 2,000 cubic feet	\$4.00	\$4.00	\$7.85

Ancillary Charges	Current Rate	Proposed Rate
Credit Card Processing Fee	N/A	\$0.75
Credit Card Chargeback Fee	N/A	\$20.00

Average Bill Comparison

Average Monthly Usage 566 cubic feet	Current Rate	Proposed Rate	Revised Rate
Base Rate (¾-inch meter)	\$30.95	\$35.95	\$22.05
0 – 500 cubic feet	\$10.00	\$12.50	\$17.75
501 – 566 cubic feet	\$1.32	\$1.82	\$3.00
Average Monthly Bill	\$42.27	\$50.27	\$42.80

Commission staff has completed its review of the company's supporting financial documents, books and records. Staff's review shows that the expenses are reasonable and required as part of

the company's operations. The company's financial information supports the revised revenue requirement and the revised rates and charges are fair, just, reasonable, and sufficient.

Conclusion

1. Issue a Complaint and Order Suspending the Tariff Revisions filed by Aquarius Utilities, LLC; and
2. Allow temporary rates at the staff recommended revised rates to become effective July 14, 2008, on less than statutory notice, subject to refund.

Attachment

Staff's Summary of Customer Comments and Staff's Responses

- **Customer Comment** – Object to the rate increase until Aquarius' rate related expenditures are audited by the Concerned Citizens of Greater Diamond Point (CCoGDP).

Staff's response – Staff conducts its own independent audit of the company's financial records. Consumer Protection and Communication staff advised customers that they have access to everything the company has filed with the commission through "Records Center" or the commission's web site (<http://www.utc.wa.gov>) and that they may contact Dennis Shutler at 360-664-1108.

- **Customer Comment** – Withhold rate approvals until all conditions are met. CCoGDP or the regulatory agencies should not give up the only advantage (money) they have, while important issues are unresolved. Aquarius misled readers of the Drinking Water State Revolving Fund (DWSRF) Loan applications about having negotiated a Franchise Agreement with Clallam County when it did not. Clallam County sent Aquarius a notice that failure to comply with a new Clallam County Franchise Agreement to the County Prosecutor by May 29, 2008, will result in penalties and fines. Clallam County will excuse past penalties and fines of \$12,000 for Aquarius and its customers between 2000 and 2008.

Staff's response – The franchise agreement is signed. Although the annual expense and set-up fee (which was capitalized) are included in the rate case, no past due fines were included. Also, the commission cannot hold a rate case "hostage" to accomplish non-rate case goals. The county has the ability to enforce its own franchise agreements. Commission staff works closely with the DWSRF staff in evaluating loan applications. DWSRF staff is knowledgeable and capable of administering the agency's program.

- Aquarius failed to obtain a rate increase from the UTC by the June 4, 2008, due date as a condition for approval by the Public Works Board (PWB) on the four new 2008 DWSRF Loan requests. The PWB Board of Commissioners granted an extension of another three months at their meeting on June 3, 2008.

Staff's response – The PWB has the ability to operate its program. It is not clear to staff whether customers incurred any expense in this regard.

- The Eagles Rest residents agreement with Aquarius to fix continuing drainage problems on their properties remains unresolved.

The proposed Diamond Point (DP) tank upgrades exceed earlier agreed upon scope.

CCoGDP had to retain a lawyer to obtain information on the company's water system plan and its DP upgrades.

Staff's response – The Department of Health (DOH) has jurisdiction over water system plans and scope/design of those water system requirements. DOH has the ability to

enforce its own rules and requirements. Staff conducts its own independent audit of the company's financial records. Also, the commission cannot hold a rate case "hostage" to accomplish non-rate case goals.

- **Customer Comment** – Can the Utilities and Transportation Commission explain the advantage of its "Single Tariff Pricing" as applied to DP residents? Why isn't a balance or checkpoint included in the single rate principle, to prevent the punitive rates we are continuing to experience? A previous meeting at the commission held in 2003 was not concluded satisfactorily, although we were assured that the rate increases would balance out with the increase in new customers. Doesn't the UTC have a legal responsibility to ensure a fair and balanced implementation for all customers?

Staff's response – Staff recommended, and the commission adopted, a policy to set rates using a single rate. Staff believes the "Single Tariff Pricing" does result in rates that are fair, just and reasonable. This is a public policy issue and is best explained as similar to an insurance pool or postage stamps – the risks and costs are distributed to all customers and every customer pays the same rate. Washington was one of the first states to adopt single tariff pricing in the early 1990s. The US EPA later endorsed single tariff pricing and most other states have adopted that policy.

- **Customer Comment** – To add insult to injury, Aquarius proposes a \$1.6 million pipeline replacement project for DP, to be funded via a \$5 per month surcharge per customer. Aquarius claims an annual budget of \$50,000 for incremental implementation. Why would the UTC even consider such a cash stream? We will have to live with torn up streets for nearly 32 years. This is totally unacceptable; all of DP suffering and paying for Aquarius's failure to execute two DWSRF funded projects in a timely fashion. CCoGDP considers this proposal a reward for extremely poor management and it is highly unlikely that such a surcharge can be collected without extreme protestation by the community.

Staff's response – Aquarias did not propose a \$5 per month surcharge.

- **Customer Comment** – There were two incidents that incurred expenses between 2004 and 2005 that DP customers should not be asked to pay for, due to negligence and deception during a DOH System Audit in 2004:
 - Well #1's failure revealed that Well #2 was out-of-service. The Well #1 pump motor failure, combined with "seasonal backup" Well #2 being non functional for an undetermined number of years, resulted in residents located in the upper elevations having to boil water and low water pressure in regions for weeks. On February 10, 2004, Jim McCauley (DOH) stated that Well #2 represented the seasonal back up by Aquarius. This resulted in the company spending approximately \$30,000 to buy two new well pumps for the water system.

Staff's response – According to DOH, the system has a "green" rating, which means the water system complies with DOH rules and regulations. Staff audits the

company's financial records, including assets (i.e. motor pumps and wells). The company has the opportunity to recover any assets that are deemed necessary and reasonable, which are capitalized over the assets useful life.

- A Qwest cable was cut on Discovery View Drive in 2005. During the repair of a water main leak, no prior locates of cables, pipes and wires were done before digging, which resulted in a backhoe cutting 30 phone lines. A Qwest repairperson notified a customer that they had to look for the cable cut for three days before finding the location. They had worked for three days changing out phone lines for 30 customers. Aquarius admitted its failure to do a "locate" prior to the repair of a water pipeline, plus no notice was given to Qwest of the cut in the phone lines. DP customers do not want costs associated with the cut phone lines included with the proposed rate increase.

Staff's response – This issue is outside of the test period. Reimbursement for phone line damages are not incorporated into the current rate increase. Also, any fines or penalties are not included in general rates.

- **Customer Comment** – Lack of maintenance on the "altitude valve" at the cement water tank caused an overflow from the lid resulting in 125,000 gallons of water onto neighboring homes, which happened three times in three months during 2005.

Staff's response – The DOH has jurisdiction over water system plans and scope/design of those water system requirements. DOH has the ability to enforce its own rules and requirements.

- **Customer Comment** – The original DWSRF loans were lost in 2006, one of which was to replace DP customer's obsolete pipe infrastructure system. The PWB ended up pulling the loans from Aquarius for failing to perform the proposed projects within three years of approval of the loans. Any new costs to reapply for DWSRF loans should not be passed onto customers due to Aquarius procrastination.

Staff's response – All expenses for the DWSRF loans that were lost in 2006 were incurred between 2003 and 2006, which are after the last rate increase (2002) and before the current rate increase test period (2007). The cost incurred to reapply for any current DWSRF loans that are within the test period is a water system plan that is required by DOH. This item is a required expenditure for all water companies, which is capitalized over six years with a ten percent salvage value.

- **Customer Comment** – The Department of Health had not received a Water System Plan for Aquarius from 1998 to 2008, which put them in a non-compliance status for 3 years. Customers should not have to pay for the administrative costs for Aquarius to prepare a WSP 10 years late.

Staff's response – According to DOH the system has a "green" rating, which means the water system complies with DOH rules and regulations. A regulated company has the right to recover reasonable costs (other than fines and penalties) incurred to comply with government

requirements. Water system plans are capitalized over six years with a ten percent salvage value.

- **Customer Comment** – One of the customers of Aquarius reviewed the financial reports submitted by Aquarius and noted the following problems or questions:
 - On line 46 of the “statement of cash flows” is a year-end number, not beginning of year. It does not track if you follow the cash flow statements, but bottom line 47 should be cash on balance sheet for 2007 in the amount of \$3,747.

The annual report of the water company on cash flow statements for 2006 statement comparing 2005 to 2006, the numbers are not the ones used on the comparison statement of 2006 to 2007, what is that? Same with comparison balance sheet numbers for 2006 is not the same on both reports. Once again, on the cash flow reports, 2005 & 2006 on the 2006 report do not balance to cash.

Staff's response – A statement of cash flows reflects a firm's liquidity or solvency. It is also useful in determining the short-term viability of a company, particularly its ability to pay bills. Staff does not use cash flow statements in our analysis. Staff uses general ledgers, depreciation schedules, profit and loss statements and balance sheets, which results in staff making various restating adjustments and proforma adjustments to the financial records. In addition, staff does not penalize the company for preparing statements incorrectly.

- According to the “regulatory fee calculation schedule”, line 4e is incorrect; this amount should be $\$358,523 \times .002 = \717.05 , while line 5 should be \$767.05.

On 2007 Profit & Loss statement there are \$767.10 in penalties and fines, customers should not have to pay for that.

According to the balance sheet for “water utility plant (101)”, its total for 2007 was \$1,841,783.72, unless something was missed, but it is very difficult to track the company's numbers back to balance sheet.

On the customer notice letter, there weren't any calculations of the “admin & operating expense” to show the \$407,615 amount. Admin & operating expenses for 2007 were \$367,817 making the \$407,615 and increase of \$39,798 in the notice.

According to the “business debt schedule”, Atlas loan owes \$20,600 on April 2008, but is due to be paid off by June 2008.

What is “other assets” for \$58,314 on the depreciation schedule listed under 2007?

How do we know that the expenses claimed are correct and how do they compare to other water companies? How much is Mr. Roats being paid by the company? Does anyone do any audit comparing income to B&O reports filed with the state, payroll

expense to FUTA, Form 941's and SUTA tax reports? How can we know what percentages should be?

Staff's response – Staff conducts its own independent audit of the company's financial records, which results in staff making various restating adjustments and proforma adjustments to the financial records. A regulated company has the right to recover reasonable costs (other than fines and penalties). Staff's audit takes into account capital structure (debt vs. equity), interest synchronization adjustments, net-to-gross conversion factors and revenue requirement calculations.

- On 2007 balance sheet under liabilities, what is Contribution in Aid-Construction (CIAC)?

Staff's response – CIAC is any amount of money, services, or property received by a water utility from any entity that is provided at no cost to the utility. Sources of CIAC include developer donated property or plant, service connection charges, surcharges or any other gift of money or property. These sources of money and property carry no obligation of repayment and, therefore, no cost to the utility company that needs to be recovered in rates from current customers.

- On the customer notice letter, there is mention of “rate of return, including interest on borrowed funds” in the amount of \$51,300, what is this item? Interest expense was just over \$18,000 for 2007.

Staff's response – Capital plant cost or rate base is the original total cost of a utility's plant in service (UPIS). This UPIS is used in determining a recovery of invested capital cost and an authorized return on investment. The total recovery cost is based on the rate base of a water utility and the authorized weighted cost of capital for that water utility. Any excess price paid above historical cost is normally not considered as part of rate base. Additionally, any prior period or startup losses incurred are also not considered as part of rate base.

The recovery of capital cost is considered an expense through straight-line depreciation. The amount of depreciation allowed is based on the historical cost and the useful life of the asset under consideration. These funds normally return to the source of the original financing.

Cost of money or rate of return is based on the cost of capital and is the composite rate of the cost for debt interest and equity stock earnings. It is the composite of the weighted cost of the various capital sources used to provide the assets used in supplying water utility service. A company that invests in plant recovers the amount of the original cost in the form of depreciation and earns a return (12% on equity and actual cost of third party debt) on the un-depreciated balance.

Rate base is determined by historical cost of all plant assets used for providing water service less accumulated depreciation and less any contribution in aid of construction

(CIAC). Historical cost is established as the original cost to the utility that places the plant in service to customers. In reviewing the rate base, only used and useful plant that is functioning and necessary for the current customers would be included in determining rates.

- How much is Mr. Roats charging the company for engineering that perhaps the water users would be better served by hiring a third party to do the work so we can once again have confidence in our system?

Staff's response – Mr. Roats charged the company \$45 per hour for engineering services, which staff concluded is comparable to other engineering firm's prices. The costs were capitalized over the useful life of the assets associated with the work.

- It was reported that two new vehicles were purchased, are they used 100 percent for business? If not, is the company being reimbursed for outside use?

Staff's response – During staff's field visit, the two new vehicles were being used for company purposes and staff has no reason to believe otherwise. However, staff cannot be certain that the company's vehicles are used strictly for business.

- On Profit and Loss Statement for 2007 – wages and salaries (acct. 6010) – was listed as \$168,274.95, but payroll expense reports submitted shows gross of \$206,659.28. The difference being \$40,015.83. Where is this item on the P&L?

Staff's response – Wages and salaries related to the water system plan were capitalized at the end of the year. Therefore, a portion of the wages and salary was reduced and transferred to the company's balance sheet.

- On Balance Sheet for 2007 – Notes Payable – Other (acct. 2550) there is an amount for \$23,918.94, what is that?

Staff's response – This item is a US Bank auto loan for a 2007 Chevy, which was originally purchased from Courtesy Chevrolet on a 9.04 percent interest rate, but refinanced by US Bank with an interest rate of 7.7 percent.

- According to the accounts receivable (acct. 1430), due to/from GGR for \$5,000? Is that Mr. Roats?

Staff's response – Yes, the owner took an "owner draw" out of equity, which reduces the owner's portion of equity and lowers the rate of return.