

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

WASHINGTON UTILITIES AND)	DOCKET UW-060343
TRANSPORTATION COMMISSION,)	
)	
Complainant,)	ORDER 05
)	
v.)	
)	INTERLOCUTORY ORDER
ILIAD WATER SERVICE, INC.,)	REJECTING TARIFF, DEFERRING
)	ACTION AND DIRECTING
Respondent.)	INVESTIGATION
)	
.....)	

1 **Synopsis:** *The Commission modifies an Initial Order rejecting a proposed water company tariff. We affirm a finding that the Company did not prove that its proposed tariff to fund water quality equipment met pertinent standards. We accept the Company’s suggestion that further consideration of a surcharge tariff be deferred pending efforts to secure a subsidized-interest loan. Consistent with the Company’s suggestion, we attempt to fashion an agreed longer-term solution to the Company’s problems by ordering an investigation into the surcharge proposal and the Company.*

2 **Nature of the Proceeding:** This matter involves a request for tariff revision filed on March 1, 2006, by Iliad Water Service, Inc., (Iliad or Iliad Service) to charge its customers a one-time assessment of \$3,405, payable at the customer’s option at \$49.26 per month for ten years, to fund the installation of a water chlorination system purporting to cost \$132,795.¹

3 **Procedural history:** Iliad Water Service, Inc., (Iliad), filed a tariff revision for a surcharge effective April 1, 2006. The Washington Utilities and Transportation Commission (Commission or WUTC) suspended the tariff and convened an evidentiary hearing before Administrative Law Judge Patricia Clark on November 8 and 9, 2006, in Olympia, Washington. A hearing was convened in Eatonville, Washington, on November 14, 2006, to receive public comment. The parties filed

¹ Staff calculated project costs of \$125,183. Iliad modified its proposal to accept Staff’s financial analysis. On brief, Staff reported an error in its prior calculation. Although recommending rejection of the tariff, it proposed a project cost of \$120,899 or a *pro rata* assessment of \$3,099.

post-hearing briefs on November 29, 2006, and Judge Clark entered an initial order on January 10, 2007, proposing to reject the tariff.² The Commission served a notice of possible review and the Company waived the February 1, 2007, suspension date for 30 days; the Company sought administrative review; and Commission Staff responded in support of the initial order.

4 **Appearances:** Michael Fassio, Assistant Attorney General, Olympia, Washington, represented the Commission Staff. Richard A. Finnigan, attorney, Olympia, Washington, represented Iliad Water Service, Inc.

5 **Summary.** The principal issue is whether Iliad's proposed tariff revision for the Alder Lake Community Water System (Alder Lake) is just, reasonable, and sufficient.³ We agree with the initial order's conclusion that the proposed tariff must be rejected.

6 We accept the Company's proposal on brief that the docket should be held open pending the gathering of additional information and the filing of a replacement tariff. However, we also note that the Company's financial health and management are in question and that further questions must be answered before we can approve a subsequent tariff. Therefore, we direct Staff to conduct an investigation.⁴ To provide an optimal basis for an application to the Drinking Water State Revolving Fund, the investigation must be concluded and a report filed by May 1, 2007,⁵ unless extended by further order.

BACKGROUND

7 **The Company and the System.** Iliad Water Service, Inc. (Iliad), is owned by Derek Dorland. It serves 89 customers through three water systems, including Alder Lake which serves some 39 customers. Derek Dorland, who testified that Iliad purchases maintenance services from Iliad, Inc., a company owned by his father, David Dorland. Derek Dorland also serves as superintendent of Iliad, Inc., which managed the engineering study for the proposed chlorination facility. It also issued the invitation to bid, managed the contractor selection process, and was selected as the successful bidder.

² The order also rejected a motion to reopen the record, to which no party took exception

³ RCW 80.28.020.

⁴ The Company notes the challenges imposed on small companies by formal process. We share that concern and encourage the Company to join in a collaborative investigation.

⁵ This deadline is timed to coordinate with the next application period for subsidized water facility funding.

- 8 **Need for the Project.** Alder Lake serves a community in Pierce County, Washington, near Mount Rainier. The Department of Health (DOH) determined from the system's wells were hydrologically connected to Alder Lake, and the water supply was vulnerable to contamination from the Lake's surface water. The DOH directed Iliad in December, 2000, to add a chlorination facility to the Alder Lake system. The proposed tariff is designed to fund the design and construction of that facility.
- 9 **Brief Project History.** The DOH approved the plans and authorized Iliad to proceed with the project on January 31, 2002. Iliad awarded a contract for the project, and submitted a proposed surcharge tariff in October, 2004. The Company discussed the proposal with Staff, then withdrew it in March, 2005, at least in part so Iliad could investigate the availability of low-interest financing through the Drinking Water State Revolving Fund at 1.5% per year interest. The project has not yet been built.

THE PROPOSED TARIFF

- 10 On March 1, 2006, Iliad filed a second proposed tariff – its current filing – similar to its earlier proposal. This proposal would fund a one-time \$132,795 charge, with each customer responsible for \$3,405. As before, customers could make a one-time payment of the full amount, and are free to secure their own financing of the amount. They may, if they choose, make monthly payments of \$49.26 over ten years to reimburse Iliad for its financing expenses.⁶
- 11 Staff challenged the proposed tariff on two principal grounds; unreasonable delay in pursuing the project and an unreasonable interest rate for customers choosing to finance their payments through Iliad.
- 12 **Project costs and delays.** The initial order accepted Staff's argument that the inordinate delays in preparing for construction were clearly imprudent. At this point, more than six years have elapsed since the first DOH directive to the Company to install chlorination facilities, and construction has not begun. Iliad offered no excuse for the lengthy time period other than to say it was busy with other projects. There is no record of what other projects involving an Iliad system – or any other system, for that matter – may have caused delays, or why their priorities would have trumped those of the health-related project.

⁶ The proposal does not credit ratepayers for tax purposes with the payment of interest on the loan.

- 13 After Iliad withdrew its earlier proposed tariff, Iliad, Inc. conducted a new bidding process for the chlorination project on behalf of the Alder Lake system. The successful bidder was Iliad, Inc. Its bid – although higher than the successful bid supporting the 2004 tariff request – was lower than bids of the two other bidding contractors. Iliad has acquiesced in a total project cost of \$118,000, which assumes a project cost upon which both parties have agreed. The initial order found insufficient proof that the bidding process was flawed but found that the delays in proceeding with the project, including the tariffs, were imprudent and unreasonable. We accept the initial order’s conclusions.
- 14 **Interest rate.** The initial order also accepted the Staff arguments opposing the reasonableness of the rate for persons who chose not to pay the entire surcharge at once. The order ruled that Iliad’s failure to select and pursue financing from a state-administered fund was unreasonable, and that the resulting rate was unreasonable. On this issue, Staff faulted both the selection and the process by which the selection was made.
- 15 Iliad withdrew its earlier tariff with the express representation that it would explore the availability of state-subsidized financing from the Drinking Water State Revolving Fund at 1.5%. Yet Iliad’s current filing merely repeats the earlier option of commercial financing at 11%. Iliad explains that its contracting engineer said that Iliad was not eligible for the lower-interest financing, and Iliad had no knowledge to the contrary.
- 16 The record, however, shows that Iliad regularly received publications that described the state program and referenced qualifications that demonstrated the eligibility of systems such as Iliad’s for projects of the sort that DOH requires. The record also shows that Iliad has been in contact with DOH staff that could have been knowledgeable direct sources of information about eligibility requirements or referred the Company to such sources.
- 17 The record does not show the source of the engineer’s information, which conflicts with information regularly distributed to Iliad. Iliad did not offer testimony from the engineer to verify the nature of and reasons for the advice -- nor did it offer any reason why it was unable to make a telephone inquiry directly of the source, or to read the frequent publications of information about the process, or to submit an application to determine eligibility. We agree with the initial order’s decision that these failures were unreasonable and imprudent.

18 We acknowledge that the total project cost over 20 years⁷ would be higher with the state-subsidized financing than under the 10 year option in the tariff Iliad proposed. The evidence shows, however, that under the state-subsidized program the interest rate, the discounted present value of the cost, and the monthly payment required of system customers would all be significantly lower.⁸

19 We affirm the initial order's findings that the failure to pursue the state-subsidized financing was imprudent and on this record the tariff cannot be considered just or reasonable.

LONGER TERM PROCESS

20 **Suspension of the proceeding.** The next question, and the more perplexing, is what actions with regard to the project and the system are prudent for the Company and in the public interest.⁹ The Company offers a suggestion that will assist in resolving many of the questions that arise from this record – to “hold this case open,”¹⁰ allow the Company to apply for a state-subsidized loan at the lower interest rate, and permit refiling at a later date.

21 We accept the Company's suggestion. Technically, we reject the proposed tariff but hold the docket open for the Company to refile a tariff or tariffs when answers to a number of questions are known.

22 One question is the response of the Department of Health to this decision. We have no control over whether the DOH will forbear action on the system and what, if any, regulatory action on our part might be required. A second question is whether, and when, state-subsidized funds will be made available for the project and ultimately the proper cost of the project, including financing costs.

23 **Questions and concerns.** This record, however, is replete with other questions that should be addressed before refiling.

⁷ It is not clear in the record whether 20-year financing is the only subsidized option available.

⁸ The tariff is based on ratepayer responsibility for the total cost of interest payments that would presumably be a deductible expense for the Company, a savings not reflected in the parties' calculations.

⁹ Regulate in the public interest. RCW 80.01.040(2).

¹⁰ Iliad petition for review.

- 24 There is serious doubt whether Iliad is on sound financial footing, based on its \$152,000 negative net worth – it owes more than twice the \$90,000 value of its assets. Counsel reports that the Company lost nearly \$25,000 in 2005, and more than \$45,000 when interest expense is considered. Yet there is no indication that the Company has ever sought a general increase in its rates. As with the lengthy delay in pursuing the chlorination project, this raises questions about the abilities of Company management. It cannot be in the best interests of the ratepayers, the public, or the Company owner to continue imprudent management. We need to consider whether it would be prudent or in the best interests of the ratepayers to approve any tariff for this project if the Company is not prudently managed.
- 25 Another question is how the various Iliad operations are structured and how costs are determined and apportioned. The Alder Lake system is shown as having 39 customers; others under Iliad Water Systems bring the total customer count to 89. It is not clear whether Iliad is independent or whether it is operated in conjunction with the other water systems served by Iliad, Inc. The investigation should determine whether the operators of the various systems constitute a unified management, whether the current structure is prudent or whether the water service of all the systems should be considered to be under single management, and whether the costs of the project should be spread among a larger base of customers.
- 26 We agree with Iliad’s counsel that adversarial proceedings can be costly and frustrating processes. Moreover, they can be time consuming. We therefore encourage this inquiry as a collaborative process involving both Staff and the Company in a speedy but thorough undertaking for the best interests of all concerned.
- 27 All of the identified factors bear on the possible surcharge, as well as the viability of the Company to continue in operations as presently funded, managed and organized. To the extent that the results might not be agreed, Staff may consider further action in this or another docket.

FINDINGS OF FACT

- 28 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. The portions of the preceding discussion that include findings pertaining to the Commission’s ultimate decisions are incorporated by this reference.

- 29 (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.
- 30 (2) Iliad Water Service, Inc. (Iliad), 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.
- 31 (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 to take certain steps, including installing a chlorination system.
- 32 (4) On March 1, 2006, Iliad filed a tariff revision to fund the installation of the water chlorination system required by the Department of Health.
- 33 (5) Iliad obtained a financing commitment for this project at the rate of 11 percent for 10 years.
- 34 (6) Iliad failed to pursue Drinking Water State Revolving Fund financing at the rate of 1.5 percent.
- 35 (7) Financing for the project selected by Iliad is at an interest rate that is substantially more expensive than provided under Drinking Water State Revolving Fund financing and that results in a higher monthly expense for ratepayers choosing extended payments.
- 36 (8) Iliad obtained approval from the Department of Health for its engineering report and construction documents on January 31, 2002, but did not obtain a financing commitment until January 2003.
- 37 (9) Iliad 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.
- 38 (10) Iliad represented to the Department of Health that it applied to the Commission for approval of its fee structure on or about December 12, 2001.

- 39 (11) Iliad filed its first tariff revision with the 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 to install the chlorination system. Commission Staff did not receive pre-filing documentation to consider during that period.
- 40 (12) On May 24, 2005, Iliad withdrew its first tariff filing, *inter alia*, to investigate Drinking Water State Revolving Fund financing and issue a new invitation to bid the construction of the project.
- 41 (13) On December 2, 2005, approximately seven months after it withdrew its initial tariff filing, Iliad issued a second invitation to bid for construction of the project. The current low bid for the project was received on December 15, 2005.
- 42 (14) Iliad 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. 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. The current successful bid is approximately 59 percent higher than the first bid.
- 43 (15) Iliad filed its second tariff revision with the Commission, on March 1, 2006, more than five years after the Department of Health directed installation of the chlorination system.
- 44 (16) More than six years after directed to do so by the Department of Health, Iliad has not commenced construction of the chlorination system.
- 45 (17) Questions exist about whether the cost of the chlorination facility should be spread over only the 39 customers of the Alder Lake system or a larger universe of customers under a prudently managed system. Questions also exist about the management of the Company and its organization, and whether the Company needs an increase in its rates to meet its prudent expenses. These questions may be answered by the results of a Staff investigation.
- 46 (18) Iliad proposes suspension of activity in this docket pending an application for state drinking water fund financing.

CONCLUSIONS OF LAW

47 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.

48 (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.

49 (2) Iliad Water Service, 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.

50 (3) Commission Staff should be directed to investigate whether the Company needs rate relief and how a surcharge rate should be calculated and spread among customers, and to file its report with the Commission by May 1, 2007.

ORDER

THE COMMISSION ORDERS That

51 (1) The proposed tariff revision to fund a water chlorination system filed by Iliad Water Service, Inc., is rejected.

52 (2) This docket is held open pending the Staff investigation identified in Conclusion of Law No. 3, above, and consideration of its conclusions, and a determination as to funding under the Drinking Water State Revolving Fund.

53 (3) We direct the Staff to institute an investigation into the Respondent, and invite the Respondent to join in a cooperative inquiry. The aim will be to determine with reasonable accuracy (1) the cost of the proposed facility, including the proper allocation of its costs among investment, loans, and advances for ratepayer reimbursement through surcharges; (2) whether this Company is

viable, given its balance sheet, recent losses, the current rates for its systems, its failure to request rate relief, and the quality of management evidenced on this record; (3) the proper relationship between the Alder Lake System and other Iliad systems and among systems under common or related ownership or de facto management, as a step in determining the proper allocation of project costs and ongoing operations to ratepayers, and (4) a financial and management plan, including possible rate relief, that will ensure the Company's prudent management and financial viability at reasonable rates, for the protection of its ratepayers. The Staff shall file its report by May 1, 2007, unless time is extended for good cause by further order.

Dated at Olympia, Washington, and effective February 28, 2007.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner