

Agenda Date: November 28, 2007
Item Number: A5

Docket: UW-071885
Company Name: Iliad Water Service, Inc.

Staff: Amy White, Regulatory Analyst
Dennis Shutler, Consumer Program Specialist

Recommendation

Issue a Complaint and Order Suspending the Tariff Revisions filed by Iliad Water Service, Inc., in Docket UW-071885.

Proposed Filing

On September 17, 2007, Iliad Water Service, Inc. (Iliad Water or company), filed increased rates for \$32,324 (143 percent) additional annual revenue. The company made the filing to help cover increased operating costs. Iliad Water serves 89 customers on the following three systems:

System Name	County	Nearest City	Customers
Alder Lake	Pierce	Elbe	39
Western Stavis	Kitsap	Silverdale	27
Cascade Crest	Snohomish	Marysville	23

Depending upon the system, customers pay either flat or metered rates. The proposed metered rates include 500 cubic feet of water in the base charge and one rate block for all water used over 500 cubic feet. The company's last general rate increase was in August 1992 at the time of the company's initial tariff filing. The company notified customers of this increase by mail on September 17, 2007.

Customer Comments

The commission received eleven comments: two customers of the Alder Lake system; five customers of Western Stavis; two from Cascade Crest customers; and two customers who did not identify themselves with a particular system. Also, six customers from Alder Lake and one from Western Stavis attended the October 10, 2007, open meeting to make comments. The customers are concerned about:

The size of the increase. Although staff understands the customers' concerns regarding the amount of increase, we do not explicitly consider the amount of the increase in preparing our recommendations. Our goal is to recommend the "right" rates that will allow the company to recover reasonable operating expenses and provide an opportunity to earn a reasonable return on investment.

The company is connecting new customers at the same time the systems are experiencing water shortages. The Department of Health (DOH) has primary jurisdiction over customer connections and water quantity. The commission did not receive customer complaints on this issue prior to the rate case.

Poor customer service. Consumer Affairs staff is working with the company and customers to ensure the company complies with commission rules and regulations. The commission did not receive customer complaints on this issue prior to the rate case.

Backup generator. Backup generators are “voluntary” upgrades. Neither the commission nor DOH requires backup generators. Customers on each water system can vote to install a generator for an additional monthly surcharge. DOH and commission staff will work with customers who are interested in pursuing this issue. The commission did not receive customer complaints on this issue prior to the rate case.

Seasonal nature of customers. Seasonal customers on metered systems affect the rates paid by non-seasonal customers. Seasonal customers pay only the base charge during the months that they are gone. That means the “usage” component of the revenue requirement is distributed over fewer customers, which means the rates are higher. Staff is fully aware of these results, but remains convinced that single-tariff pricing is appropriate and recommends the commission adopt a single-tariff, conservation rate design that ensures customers pay only for the water they use. The commission did not receive customer complaints on this issue prior to the rate case.

Poor Water quality. Customers commented at the October 10, 2007, open meeting regarding poor water quality on the Alder Lake water system. On October 22, 2007, Iliad Water filed a copy of its “Alderlake Water System Water Quality Report – April 2007” and copies of testing receipts for 2007. These documents show the water quality on the Alder Lake water system has been satisfactory. DOH has primary jurisdiction over water quality. The commission did not receive customer complaints on this issue prior to the rate case.

Docket UW-060343 (Chlorination plant – Alder Lake water system)

In 2000, DOH ordered Iliad Water to install a chlorination plant on the Alder Lake water system. In 2006, Iliad Water filed a rate case that proposed to use 100 percent third party debt to pay for the required chlorination plant and assess customers a monthly surcharge to service the debt. The commission suspended the rate proposal in Docket UW-060343, which remains open today.

On May 14, 2007, DOH issued a Notice of Penalties and Initial Order against Iliad, fining the company \$3,200 for noncompliance with the requirement to build the plant. That issue has not been resolved.

In its July 10, 2007, report to the commission, staff concluded that Iliad Water is not financially viable and recommended the company immediately¹:

- (1) **File for rate relief.** The company filed this rate case.
- (2) **Discharge uncollectible debt.** Iliad Water's debt exceeded net assets by \$187,749 at the end of 2006. Iliad Water partially addressed this issue by reporting that it has negotiated forgiveness of debt as follows:

Iliad, Inc.	\$58,715 of \$122,763 forgiven
Water Services, Inc.	\$ 715 forgiven
First California	None of \$113,172

Even after the debt forgiveness, retained earnings are a negative \$127,539 and equity is negative \$126,539. The company's November 14, 2007, Management Plan letter states it has about \$25,000 negative equity.

- (3) **File an Equity Investment Plan showing its intention to build and maintain a positive equity capital structure.** On November 14, 2007, Iliad Water filed a one-page Management Plan letter stating in part, "...the Company has determined that there will not be significant opportunities for capital investment in the short run...The owner will make every effort to fund these capital expenditures as owner's equity...if the Company does not have a positive capital structure within five years, the Company will seek a buyer and endeavor to find other investors or new ownership."

Staff disagrees. We believe the proposed chlorination plant (approximately \$178,000) provides an excellent opportunity for the company to invest equity and demonstrate that it is committed to build and maintain a positive equity capital structure.

The Public Works Board (PWB) staff concluded that Iliad Water is *eligible* for a loan from the Drinking Water State Revolving Fund to pay for the required chlorination plant. However, PWB staff is concerned about Iliad Water's negative equity and ability to make principal and interest payments. PWB staff is working with Iliad Water to identify conditions to secure a loan.

Commission staff, DOH and PWB continue to work with Iliad Water to resolve the chlorination plant issue.

Staff Audit and Rate Design

Commission staff has completed its review of the company's supporting financial documents, books and records. We conclude that Iliad Water has demonstrated that it needs \$18,026 (63

¹ Staff advised the company to complete all three by September 2007, the month the Public Works Board reviews Drinking Water State Revolving Fund (DWSRF) loan applications.

percent increase) additional revenue, not the proposed \$32,324 (143 percent increase) additional revenue.

Staff disagrees with the company's proposed rate design that includes 500 cubic feet of water in the base charge. Staff recommends a conservation rate design with (1) a base charge that provides no water use (so-called "zero usage" rate design) and (2) includes more than one usage block with increasing unit rates for each block. Staff's recommended rates are set forth in the table below:

Monthly Rates, all systems, when metered	Current Rate Per 100 cf	Company's Proposed Rate Per 100 cf	Staff Revised Rate Per 100 cf
Flat Rate Service, Alder and Stavis	\$23.13	\$56.19	\$43.50
Flat Rate Service, Cascade	\$26.26	\$59.52	NA
Metered Rate Service – 500 cf allowance	\$23.13	\$56.19	NA
Metered Rate Service – Zero Allowance	NA	NA	\$35.50
0-600 cf	NA	\$0.76	\$0.75
601 – 1200 cf	NA	\$0.76	\$0.86
Over 1200 cf	NA	\$0.76	\$1.04
Over Base allowance shown above	\$0.76	\$0.76	NA
“Start of Development” Ready To Serve (Alder & Stavis)	\$11.57	\$44.63	\$27.00
“Start of Development” Ready To Serve (Cascade)	\$13.13	\$46.39	\$32.50
Company-wide Average Bill	\$28.13	\$62.02	\$45.90

cf = cubic feet (1 cubic foot = 7.48 gallons of water)
 All usage rates are per 100 cubic feet of water used.

Conclusion

Staff agrees that the company has demonstrated that it needs some additional revenue, but we are very concerned that the company has not demonstrated that it has a plan to make this company financially viable. The company made progress in negotiating debt forgiveness, but debt still exceeds net assets. The company says there will not be significant opportunities for capital investment in the short run, but proposes to use 100% third party debt to finance the chlorination plant required by DOH. The company has not completed negotiations with the Public Works Board that will secure a loan from the Drinking Water State Revolving Fund. Continued financial non-viability places the company at higher risk that it may be unable to continue operations as a going concern.

Staff recommends that the commission decide this matter in a comprehensive way that will consider the company's proposed loan from the Drinking Water State Revolving Fund to build the chlorination plant required by DOH and the company's equity investment plan, to ensure the company is committed to a path that will result in a healthy, viable company that can serve customers on an ongoing basis.

Therefore, staff recommends that the commission issue a Complaint and Order Suspending the Tariff Revisions filed by Iliad Water Service, Inc., in Docket UW-071885.