

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

ILIAD WATER SERVICE, INC.,

Respondent.

DOCKET UW-060343

NARRATIVE SUPPORTING
SETTLEMENT AGREEMENT

I. INTRODUCTION

1 This Narrative Supporting Settlement Agreement (Narrative) is filed pursuant to
WAC 480-07-740(2)(a), on behalf of the signatories to the Settlement Agreement
(Agreement) filed in this docket. This Narrative summarizes the Agreement. It is not
intended to modify any terms of the Agreement.

2 The signatories to the Agreement are Staff of the Washington Utilities and
Transportation Commission (Staff) and Iliad Water Service, Inc. ("Iliad Water" or
"Company") (collectively, the "Parties"). Staff and Iliad Water are the only parties to this
proceeding.

3 The Parties believe it would be appropriate for the Commission to consider the
proposed Settlement Agreement on a paper record rather than hold a hearing. Should the
Commission wish to schedule a hearing on the Agreement, the Parties are prepared, in
keeping with WAC 480-07-740(2)(b), to present one or more witnesses each to testify in
support of the proposal and answer questions concerning the details of the Agreement, and

its costs and benefits. In addition, both counsel are available to respond to any questions regarding the proposed Agreement.

4 The Parties are filing this Narrative in support of the Agreement, and its four attachments, and do not intend to file additional documentation. If the Washington Utilities and Transportation Commission (Commission) requires additional supporting documents, the Parties are willing to provide documentation as needed.

II. BACKGROUND AND SCOPE OF THE UNDERLYING DISPUTE

5 On March 1, 2006, Iliad Water filed a tariff revision with the Commission, which was assigned to this docket. Iliad Water serves approximately 91 customers on three water systems: Alder Lake water system (in Pierce County), Western Stavis II and III water system (in Kitsap County), and Cascade Crest water system (in Snohomish County). The Alder Lake water system serves 40 customers.¹

6 The tariff revision proposed a surcharge on customers of the Alder Lake water system to fund the installation of a water chlorination treatment system that was ordered by the Department of Health (the DOH) in 2000. The tariff revision would have added a monthly surcharge to customers' bills in the amount of \$49.26 for a period of 10 years, with customers having the option of paying their portion of the assessment in a lump-sum amount of \$3,405. The Commission suspended the tariff on March 29, 2006.

7 The Commission held an evidentiary hearing on November 8 and 9, 2007, before Administrative Law Judge Patricia Clark. The Commission held a hearing in Eatonville, Washington, to take public comment on November 16, 2007. The Parties filed post-hearing

¹ Previous filings and orders in this docket correctly stated that the Alder Lake water system served 39 customers. Company records show that currently the system serves 40 customers.

briefs. On January 10, 2007, Judge Clark issued an initial order (Order 04), which rejected the Company's tariff.

8 On February 28, 2007, the Commission issued Interlocutory Order 05, which upheld the initial order and rejected the tariff filing. The Order directed Staff to conduct an investigation into Iliad Water and report its conclusions by May 1, 2007, and deferred action and held the docket open pending the investigation, consideration of its conclusions, and a determination as to funding under the Drinking Water State Revolving Fund (DWSRF). On April 27, 2007, the Commission issued Interlocutory Order 06, which accepted Staff's subsequent Petition for Review and Clarification of Order 05, denied Staff's request that a final order be entered in the docket, clarified the ordered investigation, and extended the filing deadline for Staff's report.

9 On May 14, 2007, the DOH fined Iliad Water \$3,200 for noncompliance with its requirement that the Company build the chlorination plant. This matter is outside Commission jurisdiction, and Iliad is presently negotiating with the DOH to resolve this issue.

10 On July 10, 2007, Staff filed an Investigation Report (Report) of Iliad Water in this docket, as directed by the Commission. The Report contained a detailed analysis of the estimated cost of installing the chlorination system if private financing or DWSRF financing was used. Staff's analysis concluded that, in fairness, only customers on the Alder Lake System should pay for the cost of the chlorination system. Staff concluded that a surcharge is the proper cost recovery method, and that, if private financing is used, allowing customers the option to choose between a one-time charge or a monthly surcharge would give

customers an opportunity to make the best economic choice fitting their circumstances. The Report also contained a detailed discussion of the Company's financial viability. In concluding that Iliad Water was not financially viable, Staff made three recommendations. Staff recommended that, by the end of September, 2007, Iliad Water: (1) file for rate relief, (2) negotiate with Iliad, Inc., and Water Services Company to discharge existing debt to these companies, and (3) file an Equity Investment Plan demonstrating the Company's plan to build and maintain a positive capital structure.

11 On August 20, 2007, the Commission issued a Notice of Appointment of Settlement Judge (Administrative Law Judge Dennis Moss), and a Notice of Status Conference. This notice acknowledged the filing of Staff's Report, and stated it was now appropriate for the Commission to initiate further process in the docket to facilitate final resolution of the issues.

12 At the request of Staff, the Status Conference between the Parties and Judge Moss was rescheduled to August 30, 2007. A settlement conference was convened on November 2, 2007, involving Judge Moss, and representatives of Staff, Iliad Water, and the DOH. The participants discussed the progress to date, and pledged to work toward a comprehensive resolution that would be in the Parties' and the public's best interests. To date, the Commission has not set a procedural schedule for resolving the docket.

13 In the meantime, on September 17, 2007, Iliad Water filed a general rate case, Docket UW-071885, seeking additional revenue. Following a preliminary investigation by Staff, Iliad Water agreed to a lower revenue requirement for the purpose of temporary rates and agreed to Staff's proposed rate design, and, on November 27, 2007, filed revised rates at

Staff's recommended levels. At its November 28, 2007, open meeting, the Commission issued a Complaint and Order, which: (1) suspended the tariff, and (2) accepted the revised rates as temporary rates and approved those revised rates to become effective on December 1, 2007, on a temporary basis, subject to refund, if the Commission determines that different rates would be fair, just, reasonable and sufficient. In its presentation to the Commission, Staff also explained the current status of Docket UW-060343. Staff recommended that the Commission decide the general rate case and the pending issues in this docket in a comprehensive way to consider the Company's proposed financing through the DWSRF, as well as consider the Company's equity investment plan to ensure the Company is committed to a path resulting in a viable company serving customers on an ongoing basis.

14 At a January 9, 2008, prehearing conference in Docket UW-071885, the Commission granted the Parties' request that settlement negotiations in UW-071885 be consolidated with those in UW-060343, and that Judge Moss be accordingly appointed as settlement judge in both dockets to assist, if needed. The dockets were not consolidated.

15 Discussions followed, and the Parties subsequently reached agreement in Docket UW-071885. The Parties filed a Settlement Agreement and Narrative with the Commission on April 8, 2008, which resolves issues particular to that docket. During the course of those negotiations, the Parties also agreed to a resolution of issues in this docket. Because the two matters are not formally consolidated, involve different issues, and are procedurally independent, the Parties drafted separate agreements. The Parties now wish to present this Agreement to the Commission for its approval.

III. OVERVIEW OF SETTLEMENT AGREEMENT

16 The Agreement represents a comprehensive resolution of the issues in this docket.

17 The Parties agree on alternative private financing of the chlorination system. The Parties recognize that, despite Iliad Water's application for a DWSRF loan, it is unlikely that the Company can meet all of the conditions required by the Public Works Board in order to secure this loan.² Accordingly, to finance the project, Iliad Water has sought, and will obtain, alternative private financing with a lender, Iliad, Inc., at an interest rate of 5 percent over 20 years. The Parties agree that this will be recovered via a customer surcharge.³ The cost of building the chlorination system shall be recovered through either: (1) a monthly surcharge on Alder Lake customers of \$19.23 per month, for 240 months (20 years) or until a principal amount of \$116,575 (minus any additional capital investment by the Company over time) has been recovered, or (2) at the customer's option, a one-time surcharge of \$2,914.38.⁴ The \$116,575 figure represents the total cost of the project less the equity that the Company commits to investing in the project. All one-time payments will be used to immediately pay down the principal amount due to Iliad, Inc.⁵

18 The Parties have agreed on a means to recover rate case costs for this docket. The rate case costs incurred by Iliad Water in the docket will be recovered by either: (1) a monthly surcharge on the Company's Alder Lake water system customers in the amount of \$4.13 per month, for a period of 36 months (3 years) or until \$5,940 has been recovered, or

² Settlement Agreement, ¶ 15.

³ *Id.*, ¶ 16.

⁴ *Id.*, ¶ 17.

⁵ *Id.*, ¶ 19.

(2) at the customer's option, a one-time surcharge of \$148.50.⁶

19 Iliad Water will provide customers with prompt notice of the surcharges with approval by the Commission,⁷ and customers will be given thirty (30) days from that notice to select one-time payments, or be billed a monthly surcharge.⁸ Under the Agreement, customers may prepay the remaining balances due for surcharges as a lump sum at any time during the duration of the surcharges, with no prepayment penalty.⁹

20 Iliad Water agrees to invest approximately \$20,425 in capital toward the chlorination project for the installation of service meters and new well house piping and appurtenances. The Company may make additional capital investments as opportunities arise.¹⁰

21 Iliad Water agrees to file a detailed report with the Commission concerning both the chlorination plant surcharge and the chlorination rate case surcharge.¹¹ The Company also agrees to file annual reports detailing the status of surcharges and the loan repayment.¹² The Agreement also resolves matters relating to three recommendations Staff made in its Investigation Report filed in the docket. The Parties agree that Iliad Water's filing in Docket UW-071885 resolves Staff's recommendation that the Company file for rate relief.¹³ The Parties also agree that Iliad Water has written off a significant amount of the debt currently owed to Iliad, Inc., partially addressing the second recommendation made in

⁶ *Id.*, ¶ 18.

⁷ *Id.*, ¶ 20.

⁸ *Id.*, ¶ 21.

⁹ *Id.*, ¶¶ 23-24.

¹⁰ *Id.*, ¶ 25.

¹¹ *Id.*, ¶ 26.

¹² *Id.*, ¶ 27.

¹³ *Id.*, ¶ 28.

Staff's Report.¹⁴ In addition, the Parties agree that Iliad Water has not filed a formal Equity Investment Plan as recommended by Staff in its Report, but has agreed to make equity investment into the chlorination project and is not precluded from investing additional capital to improve the Company's capital structure and reduce project costs subject to the surcharge.¹⁵

IV. STATEMENT OF PARTIES' VIEW ABOUT WHY THE SETTLEMENT SATISFIES THEIR INTERESTS AND THE PUBLIC INTEREST

22 WAC 480-07-740(a) requires that this Narrative include a "statement of parties' views about why the proposal satisfies both their interests and the public interest." As stated in the Agreement, the settlement represents a compromise of the positions of the two Parties. The Parties find it is in their best interests to avoid the expense, inconvenience, uncertainty, and delay necessitated by ongoing adversarial proceedings. Likewise, it is in the public interest that this docket conclude without the further expenditure of public and Company resources on litigation.

23 The Parties find it is now appropriate to resolve this docket by Agreement. The Agreement culminates negotiations between the Parties since the Commission rejected the Company's tariff filing and ordered that the docket be held open indefinitely. The Commission has held the docket open since February, 2007, pending Staff's Report, consideration of its conclusions, and determination as to the status of DWSRF funding issue. The Parties agree that Staff's Report has been filed, the Parties have considered and addressed its conclusions, and the Parties have made use of the settlement mediation

¹⁴ *Id.*, ¶ 29.

¹⁵ *Id.*, ¶ 30.

opportunity offered by the Commission. In addition, the Parties have determined that the DWSRF financing will not be available for the project. Alternative private financing is available, and the Parties have proposed a reasonable surcharge to service this financing.

24 The proposed chlorination surcharge is an appropriate means of cost recovery. It is fair, in the Parties' view, to apply this surcharge only to customers of Alder Lake, as opposed to all three water systems, as only Alder Lake customers will use and directly benefit from the chlorination system. It is also in the public interest for the Company to give Alder Lake customers notice of the surcharge options available, and give customers an opportunity to choose whether to pay the surcharge as a monthly payment, or a one-time payment.

25 The Company, having applied for DWSRF financing after the Commission rejected its tariff filing, has anticipated a determination by the Public Works Board as to the loan. As it has become apparent that Iliad Water would not be able to meet the specific conditions required by the Public Works Board to secure the DWSRF loan, the Company sought new, alternative private financing. This financing carries a much lower interest rate than the rejected private financing that was an issue in previous litigation in this docket. Also, as shown in Attachment B to the Agreement, even if Iliad Water had been able to secure DWSRF financing and obtain a chlorination surcharge, the surcharge amount to service the private financing compares favorably to that required to service a DWSRF loan.

26 In addition, Iliad Water's agreed equity investment in the project will reduce the total financed cost of the chlorination system subject to surcharge by more than \$20,000. This will benefit customers paying the chlorination surcharge. The project presents an excellent

opportunity for capital investment, and this financial commitment is consistent with Staff's recommendations in its earlier Report that the Company formulate a plan to invest equity in its treatment system and future plant additions.

27 Iliad Water's agreement to file an initial report and annual reports with the Commission concerning the surcharges adds accountability that furthers the public interest.

28 In conjunction with the Agreement filed in UW-071885, the Parties find they have reached a comprehensive resolution to recommendations by Staff expressed in its Investigation Report. The general tariff filing in Docket UW-071885, now resolved by settlement agreement, concludes Staff's recommendation that the Company file for rate relief. The last general rate increase for Iliad Water was in 1992. The revised rates, if approved, will provide needed revenue and an appropriate rate of return, and enable the Company to cease operating at a loss and better service its customers on all its systems. The Company's write-off of debt, also recommended by Staff, improves the Company's capital structure. Finally, while the Company has not filed an Equity Investment Plan, the Agreement commits the company to making specific equity investments in the chlorination plant within the Company's available means, and allows for future equity investment, if the opportunity arises. Staff finds that the recommendations in its Report have been addressed to its satisfaction.

V. SUMMARY OF LEGAL POINTS THAT BEAR ON THE SETTLEMENT

29 Under WAC 480-07-730(1), parties may file a full settlement, which is a settlement entered into by all parties to a proceeding that resolves all issues presented. The Commission has the discretion to accept such a settlement, impose conditions on its

acceptance, or reject such a settlement. WAC 480-07-750. The Agreement filed in this docket represents the entire agreement between the Parties. The Parties recommend that the Commission accept the Agreement in its entirety.

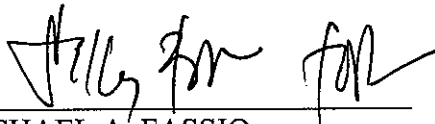
VI. CONCLUSION

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The Parties strongly recommend that the Commission adopt the Settlement Agreement filed in this docket. The Settlement Agreement fully resolves the issues presented in this docket in a manner that is consistent with the public interest.

DATED this 15th day of April, 2008.

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