

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

In Re Tariff Filing of ) DOCKET UW-070944  
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ROSARIO UTILITIES, LLC. )  
 ) MEMORANDUM OPINION  
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1 This docket involves a tariff filing by Rosario Utilities, LLC (Rosario or Company), a water company subject to Commission regulation under RCW 80.28 *et al.* Rosario filed substitute tariff sheets on August 22, 2007, designed to increase its annual revenues by around 62 percent. We considered this matter on September 28, 2007, at a recessed session of our September 26, 2007, open meeting. There we exercised our discretion to take no action, and allow the tariffs to go into effect on October 1, 2007, by operation of law. Here we explain our decision.

**I. Procedural History**

2 In December 2006, Rosario and Washington Water Service Company (Washington Water)<sup>1</sup> met with Commission Staff (Staff) to discuss the Commission’s general rate increase process and the possible sale and transfer of Rosario’s utility assets to Washington Water.

3 On April 2, 2007, Rosario and Washington Water held a meeting for Rosario water utility customers on Orcas Island. About 60 people attended the meeting. Staff participated by conference call from Olympia. The purpose of the meeting was to answer customer questions regarding the Company’s proposed general rate increase and to introduce personnel from Washington Water, who had begun negotiations to purchase Rosario’s water system assets. Rosario responded to customer questions and provided financial documents so that customers would have a better understanding about the proposal. During that meeting, Staff explained to customers the rate filing process and the sale and transfer process. Customers asked questions

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<sup>1</sup> On June 22, 2007, in Commission Docket UW-071357, Rosario and Washington Water filed a joint application for the sale and transfer of Rosario’s water system assets to Washington Water. The Commission approved that application by order dated September 28, 2007.

about the former capital improvement surcharge (which has expired) and about the capacity of the Company's water treatment system.

- 4 Rosario notified its customers of its proposed rate increase by mail on May 10, 2007, and initiated this docket by filing tariff changes on May 11. The tariff changes were designed to increase annual water service revenues approximately 62 percent. The effective date of the tariff changes was July 1, 2007.
- 5 On June 14, 2007, Staff attended a meeting with customers at Rosario Resort on Orcas Island, sponsored by Rosario and Washington Water. This second public meeting was held to respond to customers' comments and questions regarding the proposed rate increase and the proposed sale and transfer. Approximately 108 customers attended this meeting. To provide the Commission and customers' additional time to review the filing, Rosario changed the July 1, 2007, tariff effective date to September 22, 2007.
- 6 On August 22, 2007, the Company filed the replacement tariff sheets reflecting a different rate design. To enable the Commission and customers additional time to review the new rate design, Rosario extended the effective date of these tariff changes to October 1, 2007.
- 7 We scheduled consideration of these tariff changes for our August 29, 2007, open meeting, but deferred the matter to September 12, 2007, to provide Rosario customers a better opportunity to examine and comment on the rate filing, including the new rate design, as well as other documents, such as the materials Staff used to evaluate the tariff changes. Staff made available via the Commission's web site more than 60 documents and other materials related to Staff's analysis of this filing.
- 8 Many customers have taken the time to express their opinions to the Commission about this docket either orally or in writing. The Commission has received over 100 written customer comments and questions. Staff reviewed and responded to the material issues raised in these comments.
- 9 The Commission received oral customer comments at three open meetings: at the May 23, 2007, open meeting, four customers attended and participated in person, and another group of customers participated on the telephone conference bridge; at the June 6, 2007, open meeting, two customers attended and participated in person, and several other customers participated on the telephone conference bridge; and at the

September 12, 2007, open meeting, ten customers participated both in person and on the telephone conference bridge.

10 We thank all those who took the time to comment. We reviewed these materials, and as we explained at the September 28, 2007, open meeting and discuss in more detail below, we allowed the tariff changes to go into effect on October 1, 2007, by operation of law.

## II. Statutory Background

11 In general, a water company subject to Commission regulation changes its rates by filing tariff changes with the Commission. The tariff changes are usually effective 30 days after the Company gives notice to its customers and files the tariff changes with the Commission. *RCW 80.28.060 and WAC 480-80-121*. That is the procedure Rosario used in this docket.

12 The Commission has the discretion to suspend the effect of such tariff changes before their effective date, but is not required to do so.<sup>2</sup> *RCW 80.04.130*. If the Commission does not suspend the tariff filing before its effective date, it becomes effective on that date. If the Commission suspends the tariff filing, the changes do not become effective for a period of time.<sup>3</sup>

13 It is important to understand the significance of these scenarios, apart from the tariffs' effective date. When the Commission suspends the effect of a tariff filing, holds a hearing, and issues an order setting rates, the Commission makes findings of fact deciding the appropriate rate base amount, the fair rate of return, and the appropriate operating expenses used to calculate the utility's revenue requirement and new rates. That order sets precedent.

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<sup>2</sup> *RCW 80.04.130* places constraints on the Commission's power to suspend in certain circumstances, but those circumstances do not exist here.

<sup>3</sup> If the Commission suspends the effect of the tariff before its effective date, the tariffs do not become effective on the effective date. Suspended tariffs become effective ten months after the effective date, unless before then, the Commission issues an order establishing a different rate "after hearing and decision." *RCW 80.04.130*. The Commission may also allow tariffs to go into effect subject to refund, pending a hearing on the tariff filing. *State ex rel. Puget Sound Navigation Co. v. Dep't of Transp.*, 33 Wn.2d 448, 246 P.2d 456 (1949).

- 14 By contrast, when the Commission does not suspend a tariff filing, the Commission does not make findings on these matters, and no precedent is set.<sup>4</sup>
- 15 We receive around 350-450 tariff filings each year from utilities subject to our regulation. We review these filings and on average suspend less than 10 percent of them.<sup>5</sup>
- 16 The issue before us is how we should exercise our statutory discretion. We may take no affirmative action, and the proposed tariff changes will go into effect by operation of law on October 1, 2007. Or, we may suspend the tariff filing, and set this matter for hearing.

### III. Positions of Interested Persons

- 17 Although we were presented with a wide variety of positions, it appears that the revenue requirement sought by the Company was not contested. The issues raised by the comments can be classified into four categories: A) valuation of the Company's purchase of ten acre feet per year (AFY) of water rights for \$100,000; B) water rights in general; C) rate design; and D) prudence of the Company's investment in its water treatment facility. We offer a general overview of these issues, recognizing there are many more details to each than we include here. However, for our purposes, the following discussion suffices.

#### A. Valuation of the ten AFY

- 18 As Staff explained, Rosario agreed to pay \$100,000 for ten AFY of water rights, and the Company included this value in its rate base. As to the "market price" of these rights, Staff observes (and other commenters also note), there are at least two studies available, and at least one disputes that \$10,000 per AFY charge (*i.e.*, \$100,000 for ten AFY) is the correct market price.<sup>6</sup> Some commenters, relying on one of the studies, stated the market price should be in the \$2,000 per AFY range. Rosario defended the price it agreed to pay based on the market price.

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<sup>4</sup> *E.g.*, *Utilities & Transp. Comm'n v. Olympic Pipeline Co.*, Docket TO-011472, 20<sup>th</sup> Supplemental Order at ¶¶ 70-71 (September 27, 2002).

<sup>5</sup> Between the time the tariff changes are filed and a Commission suspension decision, parties work on the filing and sometimes, a utility files revised tariffs to reflect a resolution of certain issues. In this case, Rosario changed its proposed tariffs to reflect a different rate design, but it did not increase the revenue generated by the tariffs to match Staff's higher revenue requirement calculation.

<sup>6</sup> Some commenters note that the other study, which is relied on by the Company, states that it is not intended to be an appraisal.

19 However, Staff also noted that the Company purchased these water rights from an affiliate, and the Company did not provide proof of the cost to the affiliate, which is contemplated by RCW 80.16.020 and .030. Staff excluded from rate base the \$100,000 related to these water rights. Staff's revenue requirements analysis shows that even without this amount in rate base, the Company justified its rate increase request.

### **B. Water rights in general**

20 Several commenters discussed the amount of Rosario's water rights. Staff concluded that based on recent transfers and other analysis, the Company has at least the water rights contained in a water rights permit issued by the Department of Ecology, and certain adjudicated water rights (including the ten AFY discussed above), for a total of 193 AFY. According to Staff, these rights are sufficient to meet current requirements of the utility (*i.e.*, current water use customers and ready to serve customers). Some commenters believe the Company owns, or should own, a much larger amount of water rights. Staff responded that if Rosario Utilities has more water rights than 193 AFY, it may need to establish those rights in future court litigation; however, the Commission would not be the appropriate forum for that determination.<sup>7</sup>

### **C. Rate design**

21 The tariff changes before the Commission reflect a new rate design based on an analysis of meter size and usage. As the charts prepared by Staff show, the result of the proposed rate design is that each customer category pays very close to the same percentage of revenue as their percentage of water usage. The rate design reflected in the current rates charged by Rosario is based on Equivalent Residential Units, or ERUs. "ERU" is a term used by the state Department of Health and others to determine how many connections a water utility may have. Each ERU represents an average residential connection to the water system.

22 The Orcas Highland Homeowners Association (OHHA) is a customer the Company serves by a single, two-inch meter. OHHA board members stated that for many

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<sup>7</sup> The Commission notes that in Section 1.2.i of the purchase agreement with Washington Water, which is in Docket UW-071357, Rosario agrees to provide Washington Water all of the Company's intangible assets. Consequently, if the Company has more water rights than 193 AFY, and if the Commission approves the application in Docket UW-071357, Washington Water would have those additional water rights.

years, OHHA has had its own distribution system, including meters. Consequently, in Staff's view, the proposed rate design correctly treats OHHA as a single customer, not 105 customers (the number of OHHA households that take water behind that two-inch meter). OHHA members commented that they currently have a rate discount, and they wish to continue receiving that discount rate because they have their own distribution system, and they should not pay for Rosario's distribution system.

- 23 In response, Staff pointed out that for water companies, it is extremely difficult, if not impossible, to distinguish between plant that is purely "distribution" and plant that is purely "transmission." Moreover, Staff could not determine the basis for the current rate discount, which has been in effect since the Company first came under Commission regulation. Consequently, Staff contends that whether a discount is appropriate, and if so, at what amount cannot be reliably determined.
- 24 Staff also pointed out that Washington Water, which is seeking to purchase the utility, is willing to acquire the OHHA distribution system. If and when that occurs, Staff would recommend a rate design that many OHHA members seek; treatment as individual residential customers of Rosario/Washington Water, which they would then be in fact.
- 25 Indeed, by letter dated September 20, 2007, the Commission received a joint rate design proposal from Mr. Sauer, an OHHA board member, purportedly "developed jointly" by the OHHA, the Rosario Property Owners Association, and the Vusario Homeowners Association. We understand these groups represent a large majority of Rosario's residential customers. This joint customer-proposed rate design treats OHHA households as individual customers, and it is contingent upon the Company "tak[ing] over the [OHHA] water system for \$1."
- 26 This proposal could "pave the way" for the OHHA households to be treated as individual customers of the utility, as they would be if the OHHA system is transferred to Rosario. However, we understand that OHHA now proposes to sell its system for \$60,000. In response, Rosario Property Owners Association advised us that it no longer supported the "joint" customer-proposed rate design.
- 27 Suffice it to say, it is apparent that not all of the conditions contained in the September 20, 2007, joint customer-proposed rate design were met. If Rosario acquires the OHHA water system, we expect the Company to file tariff changes to reflect the rate design impact of that acquisition.

**D. Prudence of the Company's investment in its water treatment facility**

- 28 The last major issue is the prudence of the Company's investment in its water treatment facility. Rosario completed construction on the facility in 2001. Several commenters contended that Rosario's decision to use a "hydroxyl" treatment technology was not prudent, and other related decisions made by the Company made the plant less useful and less economical than it should have been.
- 29 Staff noted that it analyzed this prudence issue in the context of the Company's 2002 rate filing. At that time, among other things, Staff reviewed an independent consultant's report that analyzed the Company's decision-making at the time the decision was made, and concluded that the Company selected an alternative that would be lower cost over the life of the plant.<sup>8</sup>
- 30 Some commenters responded that the hydroxyl technology did not work out, and changes were required, resulting in cost overruns. They also contested an apparent assertion by the Company that the utility was "forced" to use the hydroxyl technology. Staff countered that while there were Department of Health (DOH) orders in effect, the utility was not "forced" to use that technology, the DOH approved that technology, and worked with the Company to implement it. When changes were required, DOH approved the changes. Moreover, many of the cost overruns were absorbed by the vendor and Rosario's parent company and are not included in the proposed rates.
- 31 Consequently, Staff concluded that the prudence issues raised in this docket do not justify a full hearing.
- 32 Related to Staff's conclusion is its observation that neither the Company nor Staff included the Company's rate case expenses (or some share of those expenses), *i.e.*, the costs the Company has incurred in this docket, including the cost of its participation in the extensive process this case has involved to date. Moreover, Staff noted that if this matter went to hearing, this rate case expense could have an even more significant rate impact, because the nature of the issues raised would require costly expert testimony and extensive discovery and hearings. Even assuming the Company recovered legitimate rate case expenses through rates over a reasonable

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<sup>8</sup> We emphasize this was Staff's conclusion; the Commission did not decide that issue.

amortization period, this could still have a significant rate impact, causing rates to be higher than the proposed rates.

#### IV. Discussion

- 33 As we have noted, we have carefully reviewed the comments and the responses and commend all those involved for their contributions.
- 34 We recognize there are many issues raised here, though some are not within our jurisdiction to resolve (e.g., water rights) and others need not be resolved now to determine the merits of the proposed rate increase. The heart of the matter is that there is no real dispute over the revenue requirement underlying the proposed rates. The valuation of the purchased water rights is not relevant now, because no amount has been included in the revenue requirement. The prudence of some treatment plant costs may be an arguable issue, but we are satisfied by the record before us that the litigation expense likely to be borne by ratepayers to determine the merits of the matter outweigh any likely benefits in this tariff filing.
- 35 We note that neither the Company nor Staff's revenue requirements analysis contains any amount for rate case expense, *i.e.*, the Company's cost of processing this matter to date. If this case were set for hearing, the Company would incur substantial additional rate case expenses, which are legitimate costs to be recovered through rates, at a prudent and representative level. The result for a relatively small utility like Rosario would likely be a higher rate than is before us today.
- 36 Our exercise of discretion on September 28, 2007, should not be interpreted as resolving or establishing precedent on issues identified in this docket other than the effectiveness of the proposed tariffs. In particular, we did not resolve the issues of the value of the 10 AFY of water rights Rosario purchased, the prudence of the water treatment plant, or the amount of water rights owned by Rosario.
- 37 We accepted the revenue requirement and rate design reflected in the proposed tariffs. We did not reach the joint customer-proposed rate design because, among other things, it is contingent on transfer of the OHHA system to the Company, which has yet to happen. If and when it does happen, we expect the Company to file tariff



changes to reflect the rate design impact of that acquisition.<sup>9</sup> We will address the appropriate rate design effect of that acquisition at that time.<sup>10</sup>

38 After considering all factors, the Commission took no action on the revised tariff filing and allowed the tariff changes to become effective October 1, 2007, by operation of law.<sup>11</sup>

DATED this 10th day of October, 2007.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

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<sup>9</sup> While the Commission will make future rate design decisions based on the information before us at that time, the Commission's policy has been to approve rate designs that promote conservation of water. This policy has stronger appeal in an island community such as Rosario, where water is a particularly scarce resource. If the utility acquires the OHHA system, the Commission will expect the proponent of any resulting rate design to demonstrate how it promotes conservation compared to other proposed rate designs. The Commission will consider other unique factors that support one rate design over another, but such factors should also be explained in detail.

<sup>10</sup> Nothing in this memorandum opinion discusses the prudence of a decision to acquire the OHHA water system, or the reasonableness of the price the Company may pay for that system. Those issues would be appropriate to consider in a later proceeding when they are properly presented for resolution.

<sup>11</sup> A petition for judicial review of the agency's exercise of discretion on September 28, 2007, must be filed within thirty days after the exercise of discretion. *RCW 34.05.542(3)*.