BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	
)	
Complainant,)	
-)	DOCKET NO. UW-000405
V.)	
)	INITIAL ORDER
AMERICAN WATER)	GRANTING MOTION
RESOURCES, INC.,)	TO DISMISS
)	WITHOUT PREJUDICE
Respondent.)	
)	

I. SYNOPSIS

In this Order, the Commission grants Staff's motion to dismiss tariff revisions filed by American Water Resources, Inc. ("American Water") without prejudice to the company. The Commission finds that American Water failed to meet its burden of proof to extend a capital improvement surcharge on two grounds: 1) American Water failed to present sufficient and reliable evidence in support of its labor and material costs; and 2) American Water failed to present sufficient and reliable evidence in support of its engineering consulting costs.

II. PROCEDURAL SUMMARY

- On March 31, 1999, American Water filed for a general rate increase in the form of a surcharge under RCW 80.28.022 in Docket No. UW-990518. American Water serves approximately 1,873 active customers on 146 water systems in six counties. The company requested this surcharge to cover the cost of the Department of Health ("DOH") critical items. The critical item list consisted of upgrades to 13 water systems as contained in the company's capital improvement plan.
- On April 28, 1999, the Commission found that American Water's tariff for surcharge was reasonable and consistent with the public interest, and the Commission approved the filing subject to conditions, effective May 1, 1999. The surcharge collections are being used to repay a bank loan.
- On March 20, 2000, American Water filed tariff revisions designated Third Revision of Sheet No. 17.3 Canceling Second Revision of Sheet No. 17.3 in this docket. The

purpose of the tariff revision filing was to request an extension of the surcharge to recover additional costs incurred for those critical items. The surcharge was originally to expire May 1, 2004, or upon recovery of the loan principal (\$380,350), plus interest and taxes, whichever comes first. Extension of the surcharge would recover an additional amount of \$102,106. The Commission entered on April 26, 2000, a Complaint and Order Suspending Tariff Revisions and Instituting Investigation.

- Also on March 20, 2000, in Docket No. UW-000404, American Water filed with the Commission certain tariff revisions designed to effect a general rate increase in its rates for water services in this state. The Commission also ordered that such tariff revisions be suspended.
- The Commission entered an Order of Consolidation and Notice of Prehearing Conference with respect to Docket Nos. UW-000404 and UW-000405 on August 14, 2000. On August 24, 2000, American Water filed with the Commission a letter withdrawing the tariff filing made in Docket No. UW-000404.
- A prehearing conference in Docket No. UW-000405 was convened on September 12, 2000, at the Commission's offices in Olympia, Washington before Administrative Law Judge Lawrence J. Berg. American Water consented to an extension of the statutory tariff suspension period to April 3, 2001. A procedural schedule established at the prehearing conference set the evidentiary hearing for January 3 and 4, 2001. Subsequently, public comment hearing dates of December 5 and 6, 2000, were set by notice. The Commission received sworn public comment from two participants.
- On December 20, 2000, counsel for American Water filed a Notice of Withdrawal and notified the Commission that American Water would proceed in this matter on a pro se basis. On December 21, 2000, the Commission served a Notice of Prehearing Conference and convened the conference on December 28, 2000, to review the issues to be addressed and the procedures to be followed during the evidentiary hearings. During the evidentiary phase, the Commission heard from five witnesses for American Water and Commission Staff.
- Parties: American Water appeared by Virgil Fox, the company President. Mary Tennyson, Senior Assistant Attorney General, Olympia, represents the Commission Staff.

III. MEMORANDUM

Background

On December 28, 2000, a prehearing conference was conducted to discuss procedural issues raised by American Water's late decision to represent itself at hearing.

Hearing procedures were discussed with Mr. Fox, American Water's President, including the company's burden to present sufficient evidence through witnesses and exhibits in support of its filed tariff revisions.

- A regulated company that makes a tariff filing exercises considerable control over the proceeding. Relevant information is generally within the exclusive control of the regulated entity. Further, the company is able to organize its information prior to filing its request and to choose when to file. However, once a tariff filing is made, statutory requirements control the time during which the Commission must take final action if the tariff filing is suspended.
- In this case, American Water had substantial control over the course of the hearing. Once the Commission timely suspended the tariff revision to extend the surcharge, only American Water could extend the time for final agency action. At the prehearing conference Mr. Fox was informed that he could request a continuance if he needed more time to prepare for the hearing. Mr. Fox responded that he was not interested in asking for more time. TR 66-67.
- At the prehearing conference, Commission Staff stated its concern about the schedule because American Water had not provided its list of exhibits (as required) and responses to Staff's discovery requests seemed incomplete. Staff shared its position that the company had not provided sufficient information to support its filing. TR 67. American Water responded that it had provided all available information in response to data requests. TR 69. Mr. Fox was reasonably informed regarding American Water's burden of proof at hearing.
- Mr. Fox was American Water's only witness during the hearing. Mr. Steven Hatton, a professional engineer who performed services for American Water, and Ms. Katherine Woods, V. R. Fox Company office manager, appeared and testified pursuant to subpoena by Commission Staff.¹ Commission Staff's other witnesses were Mr. Bill Liechty, Department of Health, Division of Drinking Water, and Mr. Jim Ward, Commission Staff revenue requirement specialist.
- 15 Commission Staff orally moved to dismiss American Water's case at the conclusion of testimony by Mr. Fox, Mr. Hatton, and Ms. Woods. TR 239-243. Staff argued that evidence presented by American Water was insufficient to determine whether its expenditures were prudent and whether those expenditures should be recovered under the surcharge The presiding officer took the motion under advisement, and Staff presented other evidence. At the conclusion of the hearing, Staff renewed its motion to dismiss. TR 403-408.

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¹ Exh. 116 and 117, respectively.

Commission Staff's Motion to Dismiss

- Commission Staff argues that American Water failed to present sufficient information to determine its costs and whether its costs are appropriately charged to the capital improvement surcharge account. Specifically, Staff argues that American Water failed to present time logs and vendor invoices to support its actual time-and-material cost detail even though such documents exist. Staff also argues that American Water has not met its burden because the company relies on a general accounting of its engineering costs and fails to allocate those costs among the surcharge projects. According to Staff, American Water's failure to timely produce all available information in response to relevant data requests prevented Staff from presenting an effective case of its own.
- American Water responds that it approached each project on a lump-sum basis. It solicited bids and awarded the surcharge projects based on the lowest total bid price received. American Water argues that it is unusual to track expenses according to time and materials when a project is bid on a lump-sum basis. TR 90-91. According to American Water, there was no reason for the company to know that such detailed reporting of surcharge project costs was necessary. American Water claims that it would be burdensome and prohibitively expensive to locate and organize that information. The company states that it did not intend to obscure or withhold information. Mr. Fox testified and represents that it will retain and present expense accounting information in more detail in the future. TR 209.
- Staff contends that American Water, as a regulated company, is obligated to maintain expense accounting records that enable the Commission to fulfill its public duty and perform its oversight role. Staff also contends that American Water was aware of the level of cost reporting detail that is necessary based on the company's 1998 rate case and other guidance provided by the Commission.
- Commission Staff further notes that the Commission may allow American Water to refile its request for a surcharge extension after it compiles sufficient backup information. Alternatively, Staff suggests that American Water treat these expenses as part of its capital expenditures and seek recovery as part of its rate base.

Discussion and Decision

Commission Staff's motion to dismiss is granted without prejudice on two grounds:

1) American Water failed to present sufficient and reliable evidence in support of its labor and material costs; and 2) American Water failed to present sufficient and reliable evidence in support of its engineering consulting costs.

American Water Failed to Present Sufficient and Reliable Evidence in Support of Its Labor and Material Costs.

- RCW 80.04.130 (2) states that at any hearing involving any change in any schedule the effect of which is to increase any rate or charge, the burden of proof to show that such increase is just and reasonable shall be upon the public service company seeking the increase. American Water must demonstrate by a preponderance of the evidence that the totality of its capital improvement surcharge is fair, just, reasonable, and sufficient. The Commission's Order approving American Water's request for a rate increase in the form of a surcharge states:
 - a. This order shall in no way affect the authority of this Commission over rates, service, or accounts, evaluations, estimates, or determinations of cost or any matters whatsoever that may come before it, nor shall anything herein be construed as an acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted.²
- American Water's request for a surcharge was based on estimated costs for engineering work plus installation and construction of thirteen critical projects.³ The Commission's approval of the company's request did not constitute a finding that the surcharge is just and reasonable.⁴ American Water may only recover such costs under the surcharge that were approved by the Commission. Because a surcharge is approved in advance of expenditures, the company must establish that costs incurred are consistent with the scope of work approved.
- American Water structured its bid process and awarded these projects for making critical improvements on a lump-sum basis. Further, the company's request to extend the surcharge recovery period is based on a lump sum accounting of costs for each project, which have not been verified as prudent or supported by other accounting records. It should have been readily apparent to American Water that a lump sum reporting of its actual costs alone would be insufficient to demonstrate that its rates were just and reasonable. Unless the company presents an itemized accounting of its costs and supporting records, the Commission is unable to determine whether they have been prudently incurred and properly recorded.
- A surcharge provides a company with a source of capital when: 1) it has insufficient funds to replace or upgrade failing infrastructure; and 2) the company cannot obtain

² In the Matter of the Application of American Water Resources, Inc. for an Order Approving Tariff Revision, Order Approving Tariff Revision, Docket No. UW-990518 (April 28, 1999); see Exh. 102.

³ See Exh. 102, attachment -- Summary List of Projects.

⁴ See also the Commission's "Complaint and Order Suspending Tariff Revisions, and Instituting Investigation" in this proceeding, dated April 26, 2000.

financing through traditional capital markets. WAC 480-110-455. American Water did not possess sufficient funds to make the necessary improvements to these water systems. Mr. Fox testified that American Water was required to obtain regulatory approval of a surcharge before it could obtain a bank loan to finance improvements in early 1999. TR 228-30.

- Mr. Fox argues that the Commission should give some consideration to the fact that 25 American Water did not know that it was supposed to account for project costs in any particular way. American Water may be due some consideration under the circumstances of this case, but not to the extent that the company believes it is entitled. The lump sum bids and accounting of project costs are no more reliable than the cost estimates that American Water presented as part of its initial request for approval of the surcharge. It is not evident from the record that the project work performed should be included in the surcharge recovery. In this context, reliability is measured by the extent to which costs can be audited and verified. The Commission cannot discharge its public duty by determining whether the rates of regulated companies are just and reasonable based on sworn affidavits.
- As it turned out, Fox Company was the lowest bidder on each of the thirteen 26 surcharge projects that were put up for bid.⁵ On three of the thirteen projects Fox Company was the only bidder, and on another three projects the bid award was decided by \$700.00 or less. Mr. Fox credibly testified that American Water's efforts to solicit bids from other companies were complicated by the need to make immediate repairs. TR 93-6. American Water benefited by the ability of a primary contractor to assign and rotate work crews among the various projects due to the urgent need to make capital improvements.
- 27 However, American Water should have foreseen that the award of each and every surcharge project to Fox Company would attract regulatory scrutiny. The Commission's approval of the surcharge required the company to seek competitive bids due to Fox Company's status as an affiliated interest. American Water could have required Fox Company to maintain and present records of its costs on a timeand-materials basis, even though the contract award was to be compensated on a lump-sum basis.
- Also, American Water received a bid from Complete Pump Company for the Terry 28 Lane project that stated it would be more cost effective for work to be performed on a time-and-material basis. Exh. 5. This bid was received prior to the bid award of seven projects and prior to the start of work on eleven projects, and American Water could have revised its cost accounting practices before work was completed.

⁶ Exh. 110 includes a "Timeline of Surcharge Projects."

- On November 29, 1999, Commission Staff requested that American Water provide a detailed breakdown of each water system project including copies of all vendor invoices and time logs for all labor. Exh. 110. On March 20, 2000, American Water responded that further detail, consisting of a volume of information "an inch to two inches in thickness," was available for review in American Water's business office. American Water filed its request for an extension of the surcharge period on that same date.
- Subsequently, Staff made successive written requests that American Water provide copies of all supporting records. Exh. 121, 123, and 124. At some point during this exchange, American Water changed its position and responded that it did not possess any of the requested records because the surcharge projects were awarded on a lump-sum basis. Exh. 123.
- Subsequently, Commission Staff requested that American Water make the books and records of Fox Company available for review at its business offices (the very same proposal that American Water had made to Staff on March 20, 2000). Exh. 114. On December 22, American Water provided a breakdown of total material and labor costs for each project, but further responded that American Water could not afford to pay Fox Company to compile time and material records. Exh. 114. The Exhibit 114 breakdown of total costs per project was produced by Ms. Woods from data that she had entered and stored in her computer. TR 169-70. American Water finds itself in its current predicament in large part because it did not instruct Fox Company to retain records in project files. Whatever additional costs may now be necessary to produce those records cannot be avoided.
- Commission Staff issued a Subpoena Duces Tecum to Ms. Woods, Fox Company's office manager, requiring her to produce time and material records for the surcharge projects. Exh. 116. At hearing, Ms. Woods did not bring the subpoenaed time and material records with her, but American Water submitted a 99-page summary of time and material costs for all of the surcharge projects prepared by Ms. Woods. See Exh. 6. Ms. Woods testified that it took her approximately six hours to print the summary of job costs in Exhibit 6. TR 169. Invoices and time cards relating to the surcharge projects were coded and entered into Fox Company's computer by Ms. Woods as they were received during the projects. TR 154-59. Ms. Woods testified that Fox Company retained these records in files according to vendors and employee names, rather than according to project names. TR 154, 167. Fox Construction normally retains records in project files only when work is performed on a time-and-material basis. TR 173.
- All records necessary for American Water to report surcharge job costs on a timeand-materials basis, rather than a lump-sum basis, currently exist in Fox Company's files. Additional work is necessary in order to retrieve the records that are summarized in Exhibit 6 from the vendor files and reorganize them by surcharge

project name. It should be noted that Exhibit 6 is substantially similar to the exhibits prepared by staff portraying the kind of cost details that should accompany rate increase filings, TR 368-72. See Exhibits 125 and 126. However, both Exhibit 125 and 126 were accompanied by copies of back-up records.

- The record in this case contains numerous references that call attention to the fact that both Mr. Fox and Commission Staff take pride in their work, and both feel that they have not received the level of respect that they deserve from the other. It is also possible to see how both sides share responsibility for their misunderstandings. For example, Mr. Ward testified that Commission Staff would have provided additional accounting guidance if American Water had asked for help. TR 386. However, Commission Staff recently refused American Water's request for help regarding its preparation of a bid document in spite of Staff's legitimate concerns regarding business dealings between companies with affiliated interests. TR 399-400, 372. Likewise, Mr. Fox admits that he behaves obstinately when he feels that other people are being unreasonable. TR 84.
- American Water cannot afford to allow misunderstandings with Commission Staff to interfere with its business judgment. Commission approval of the company's capital improvement surcharge does not guaranty American Water that it will be allowed to fully recover its surcharge. The surcharge may be withdrawn by the Commission if American Water does not provide sufficient and reliable records to support its expenditures. The information contained in Exhibit 6 was not unreasonably burdensome to produce and, at a minimum, it should have been produced in response to Staff's November 29, 1999, request.
- Staff did not have a duty to unilaterally provide American Water with additional guidance regarding the company's surcharge project accounting; however, the Commission also agrees that this kind of additional guidance would have been helpful. At the same time, the Commission shares Staff's heightened level of concern where companies with affiliated interests conduct business with each other.
- A public service company and an affiliated interest must not conduct business in such a way that obstructs or frustrates the Commission's ability to investigate and determine whether proposed rate filings are just and reasonable. Even though American Water may not have intended to be obstructive, the practical effect of its lump sum bids and accounting is that Commission Staff is unable to audit and verify surcharge project costs through American Water's records. American Water should have made time and materials records available to Commission Staff during its investigation, even though technically they were under the control of Fox Construction.
- American Water's Exhibit 6 does not, by itself, establish that its revised surcharge filing is just and reasonable. American Water must provide the Commission with

sufficient information to verify the validity of the work performed and the costs incurred. Some of American Water's project costs may not be appropriate for recovery as a surcharge.

Even though Exhibit 6 was admitted without objection, it is given minimal weight. American Water failed to timely provide Staff with a copy of the exhibit as required by the Second Supplemental Order. Parties are required to exchange exhibits prior to the hearing in order to avoid surprise and to ensure that relevant documents can be tested for their reliability as part of the hearing record. American Water deprived Commission Staff of an adequate opportunity to review the company's summary of job costs. Consequently, Staff was unable to make full inquiry regarding the exhibit's reliability.

Additionally, American Water fails to meet its burden of proof because it did not submit any evidence to demonstrate that the labor rates charged by Fox Construction complied with the terms of an affiliated interests statement filed with the Commission.

American Water Failed to Present Sufficient and Reliable Evidence in Support of Its Engineering Costs.

American Water retained Steven Hatton, a civil engineer with the firm of Howard Godat Pantier & Associates ("Howard Godat"). Mr. Hatton provided engineering and consulting services for the surcharge projects. Mr. Hatton also worked with American Water to develop the company's mandatory Water System Plan. TR 106. Howard Godat also performed other engineering services for American Water during the same time period that it worked on the surcharge projects. Unlike Fox Construction, Howard Godat did not separately retain expense records for the numerous surcharge projects; all charges for the surcharge projects. All engineering expenses were recorded in a single account, designated as Project No. 99-116. TR 117.

Both American Water and Commission Staff submitted copies of monthly invoices from Howard Godat to American Water, including a summary of billing to American Water's surcharge account for 1999 through 2000. Exh. 8, 112, and 113. These charges totaled \$101,313.10. According to Mr. Hatton, these accounting records verify the completion of projects but do not provide detail of hours worked per project. Mr. Hatton stated that he probably had invoices from his firm to American Water for other engineering work that was not coded to the surcharge account, but that it would take a considerable amount of effort to provide them. TR 131.

⁷ The Second Supplemental Order, paragraph 20, states in relevant part: "The parties must . . . exchange exhibits and exhibit lists on or before December 22, 2000."

⁸ Howard Godat Pantier & Associates is now known as Hatton Godat Pantier.

- Mr. Fox testified that the engineering costs should be allocated approximately 40% for system designs, 40% for the Water System Plan, 15% for corrosion control designs, and about 5% for evaluation of American Water's specification book. TR 207. American water did not provide any study to support these allocations. These estimates are not reliable for purposes of verifying costs to be recovered by the surcharge.
- Other anomalies in the invoices cannot be explained. For example, an engineering invoice dated October 30, 2000, for surcharge project services during the month of September on the surcharge projects contains several inaccuracies. The invoice indicates that a survey technician performed 353 hours of service at \$110.00 per hour for a total invoice amount of \$16,944.00. Exh. 113. However, Mr. Fox testified that no surveying was done on any of the surcharge projects. TR 234-35. The Commission also notes that the total invoice amount doesn't match the reported hours and hourly rate.
- Mr. Fox testified that he believed these hours were performed during the month of September to update the Water System Plan. However, another engineering invoice dated October 7, 2000, reports 128.50 hours of professional services to prepare documents and design water systems during the same time period. Exh. 113.
- The Commission is unable to verify that the reported engineering expenses were prudently incurred on the surcharge projects. American Water's failure to produce records of its actual engineering costs for each project, or to reasonably reconstruct how those costs were incurred from other records, is insufficient for the Commission to determine whether the totality of the company's engineering costs should be recovered from surcharge funds.

Conclusion

- This Order does not change the status of American Water's capital improvement surcharge approved by the Commission. The surcharge will expire May 1, 2004, or upon recovery of the bank loan principal, plus interest and taxes, whichever comes first. The Commission notes testimony by Mr. Bill Liechty, Department of Health, Division of Drinking Water. Mr. Liechty testified that the general view of DOH engineers is that American Water did a quality job on its system upgrades. TR 300. Mr. Liechty also testified that many past problems have been put to rest, and that while there are still matters for the company to address, American Water is doing a reasonably good job of managing its systems. TR 278-79.
- The Commission should allow American Water to refile its request to extend the surcharge. The company must compile records sufficient to demonstrate that its actual costs were prudently incurred and are properly recorded to the surcharge

projects. Accordingly, the Commission dismisses American Water's proposed tariff revisions without prejudice to the company.

Alternatively, American Water may seek recovery of any part of its expenses not recovered pursuant to the surcharge as costs for capital improvements in a rate increase filing.

IV. FINDINGS OF FACT

- Having discussed above in detail the testimony and the documentary evidence concerning all material matters, and having stated findings of fact and conclusions of law in the text of the Order, the Commission now makes the following abridged summary of those determinations. Those portions of the preceding detailed findings and conclusions in this matter are incorporated by this reference.
- The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including water companies.
- American Water Resources, Inc., is an investor-owned water company that owns, operates, controls, and manages one or more water systems, and serves 100 or more customers in the state of Washington.
- American Water's request to extend the surcharge recovery period is based on a lump sum accounting of costs for each surcharge project. American Water's lump sum accounting of surcharge project costs are no more reliable than the cost estimates. A lump sum accounting of actual costs alone is insufficient to demonstrate that rates are just and reasonable.
- American Water failed to present sufficient and reliable evidence on which to determine whether its labor and material costs should be recovered from surcharge funds. The company also failed to submit any evidence to demonstrate that the labor rates charged by Fox Construction complied with the terms of an affiliated interests statement filed with the Commission.
- American Water failed to present sufficient and reliable evidence on which to determine whether its engineering costs should be recovered from surcharge funds.

V. CONCLUSIONS OF LAW

The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and all parties to this proceeding.

- The Commission should dismiss American Water's tariff revision filing because the company failed to present sufficient and reliable evidence on which to determine whether its labor and material costs should be recovered from surcharge funds.
- The Commission should dismiss American Water's tariff revision filing because the company failed to present sufficient and reliable evidence on which to determine whether its engineering costs should be recovered from surcharge funds.

VI. ORDER

IT IS ORDERED That:

- The proposed tariff revisions filed by American Water Resources, Inc., on March 20, 2000, are dismissed without prejudice.
- American Water may refile its request to extend the surcharge if the company compiles records sufficient to demonstrate that its total actual costs were prudently incurred and are properly recorded to the surcharge projects.

DATED at Olympia, Washington and effective this 13th day of February, 2001.

LAWRENCE J. BERG Administrative Law Judge

NOTICE TO PARTIES:

This is an Initial Order. The action proposed in this Initial Order is not effective until entry of a final order by the Utilities and Transportation Commission. If you disagree with this Initial Order and want the Commission to consider your comments, you must take specific action within the time limits outlined below.

Pursuant to WAC 480-09-135, the time for any party to this proceeding to file a *Petition for Administrative Review* under WAC 480-09-780(2) is shortened to fourteen (14) days after the service date of this Initial Order. The shortening of time is necessary to allow time for Commission review. What must be included in any Petition and other requirements for a Petition are stated in WAC 480-09-780(3). Pursuant to WAC 480-09-780(4) the Commission designates that that an *Answer* to any Petition for review must be filed by any party within five (5) days after service of the Petition.

WAC 480-09-820(2) provides that before entry of a Final Order any party may file a *Petition To Reopen* a contested proceeding to permit receipt of evidence

essential to a decision, but unavailable and not reasonably discoverable at the time of hearing, or for other good and sufficient cause. No Answer to a Petition To Reopen will be accepted for filing absent express notice by the Commission calling for such Answer.

One copy of any Petition or Answer filed must be served on each party of record, with proof of service as required by WAC 480-09-120(2).

An original and three copies of any Petition or Answer must be filed by mail delivery to:

Office of the Secretary Washington Utilities and Transportation Commission P.O. Box 47250 Olympia, WA 98504-7250

or, by hand delivery to:

Office of the Secretary Washington Utilities and Transportation Commission 1300 South Evergreen Park Drive, S.W. Olympia, WA 9850