

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

AMERICAN WATER RESOURCES,
INC.,

Respondent.

DOCKET NO. UW-031284 &
DOCKET NO. UW-010961
(consolidated)

STAFF RESPONSE TO AWR'S
PETITION TO ALLOW USE OF
FUNDS

1 American Water Resources, Inc. (AWR or Company) filed a Petition to Allow Use of Certain Funds. Pursuant to notice dated November 3, 2003, Commission Staff submits the following response. Commission Staff respectfully requests that the Petition be denied.

I. BACKGROUND

2 During the five years of operations before 2001, AWR repeatedly requested rate increases that included additional personnel for field operations. The Commission allowed each of AWR's requests, and the company consistently failed to hire and maintain the additional positions in each instance. *WUTC v. American Water Resources, Inc.*, Docket No. UW-010961, Open Meeting Memorandum (July 25, 2001). As a result,

the Commission used a different approach when the Company requested funds for additional employees in 2001.

3 On December 18, 2001, the Commission ordered AWR to set aside \$4.40 per month from each customer payment into a separate account named the Docket 010961 Account.¹ The Commission required AWR to use the funds in the Docket 010961 Account for only the purposes set forth in the Order Accepting Settlement. Those purposes related primarily to employee expenses (salary, benefits, transportation, and payroll taxes) associated with hiring the two additional employees AWR represented to the Commission it needed.

4 On January 16, 2002, less than one month after the Order Accepting Settlement was entered, AWR executed a signed sales agreement selling its largest water system, which served approximately 25% of its customers. *See Attachment A, Sales Agreement, at 13-14.* Although AWR acknowledges that the sale of the water system eliminated the need for the projected level of employees contemplated by the Order Accepting Settlement, AWR continued collecting the \$4.40 from each customer payment until October 1, 2003. *Petition at 1; WUTC v. American Water Resources, Inc., Docket Nos. UW-031284 & UW-010961 (consolidated), Order No. 05, Order Approving and Adopting Partial Settlement Agreement (Oct. 1, 2003).*

5 AWR now requests that a portion of the money remaining in the Docket 010961 Account be used to fund litigation costs arising from a trespass claim against the

¹ *WUTC v. American Water Resources, Inc., Docket No. UT-010961, Order Accepting Settlement Agreement (Dec. 18, 2001).*

Company. Using the money from the Docket 010961 Account for this purpose is not appropriate.²

II. DISCUSSION

6 AWR argues that it is now in a position where it must defend itself against a claim, and that it has no funds available to do so. Petition at 2. The Company complains that the amount in rates for legal expenses reflect normal operating costs, but does not allow for defense of a major claim. *Id.* at 3.

7 Defense of a major claim is not a recurring event. The Commission sets rates using prudent historical expense data adjusted to reflect known and measurable changes. If litigation expenses increase after rates have been set, a company has a number of options to pay for the litigation. First, a company may use money from its operating revenue stream, provided that the company is able to maintain sufficient operations. Second, a company's shareholders may incur the litigation costs. Third, a company may obtain financing in the form of third party debt.

8 In any event, ratepayers do not pay for additional capital costs up front. Rather, costs are incorporated into rates after they have been incurred. In other words, a company usually pays for the costs associated with defending against a major claim, and those costs, if appropriate, are then recovered in rates. Nonrecurring litigation costs are typically capitalized and amortized over an appropriate period of time.

² By taking this position, Staff is not commenting on whether it believes defending the claim is prudent or imprudent. Rather, Staff is addressing the source of funds AWR may use to defend itself against the claim.

9 AWR states, with no explanation, that it has no funds available to defend against the trespass claim. That may mean the company does not have cash on hand and shareholder funds are not available. AWR makes no statement about efforts taken to secure additional capital. Significantly, AWR does not state that it is unable to obtain third party financing. In fact, Staff believes that AWR has available a \$100,000 line of credit.³ See Attachment B, Declaration of Jim Ward. To date, it appears that AWR has drawn \$53,616.44 from that line of credit, leaving \$46,383.56 available. See Attachment C, Third Quarter Report, at 5, Item 224.7 – FCB – Line of Credit #6470.

10 Using the money from the Docket 010961 Account to defend a lawsuit is inappropriate. First, the Docket 010961 Account was not intended to fund future litigation costs. Rather, it was intended to pay the costs of the additional employees AWR represented to the Commission it needed. In addition, current rates are not designed to provide excess funds to prepay unknown expenses or investments. For example, the Commission generally does not allow a company to collect money for a future investment in plant because to do so would allow the company to double collect when the plant is added to rate base. The same concept applies to litigation expenses because the expense may be recovered in future rates.⁴

³ This belief stems from information received during the last rate case. Mr. Jim Ward of Commission Staff informally contacted the company to obtain a copy of the Letter of Credit. AWR advised Staff to submit a data request for the information. Attachment B.

⁴ Double collection occurs because the company receives the money for the expense or investment from the ratepayers twice: once when the money is collected before the expense, and again when the expense is included and recovered in rates after the expense is made.

11 Second, AWR should have discontinued collecting the \$4.40 per customer
payment when it became apparent that the purpose for which the Commission allowed
the collection became obsolete. Because collection continued, the money accumulated
in the Docket 010961 Account. Treatment of the money in the Docket 010961 Account
will be resolved in the pending rate case.⁵

12 Third, AWR seems to request use of funds up to \$20,000.00 from the Docket
010961 Account without an obligation to repay with interest consistent with the market
rate for debt. Staff does not advocate that AWR be allowed to use the funds with an
obligation to repay, but rather notes that the company does not offer this option.

13 Allowing unfettered use of the funds from the Docket 010961 Account is clearly
inappropriate. In addition, allowing the company use of the funds with an obligation to
repay is not a viable option because the company seems unable to successfully fulfill
such obligations. For example, AWR failed to deposit funds as required into the Docket
010961 Account. Indeed, the Commission issued penalties against AWR's president,
Virgil Fox, for violations including failure to deposit funds as ordered and improperly
using funds from the Docket 010961 Account. *Notice of Penalties Incurred and Due for
Violations of Commission Order, Virgil Fox, President, American Water Resources, Inc.,
Docket No. UW-031596, Order No. 01, Penalty Amount: \$3,700.00 (Oct. 22, 2003).* If
AWR chooses to finance its litigation costs via debt, third party debt is a better option as
repayment will be to a third party rather than the Company.

⁵ *WUTC v. American Water Resources, Inc.*, Docket Nos. UW-010961 & UW-031284 (consolidated), Order Reopening Docket and Complaint Against Rates (August 13, 2003).

III. CONCLUSION

14 Using the money in the Docket 010961 Account is improper because that money was earmarked for specific purposes not including future litigation costs. The treatment of the money in the Docket 010961 Account will be an issue addressed in this proceeding when the issue of the company's level of rates is addressed. Moreover, AWR should follow normal ratemaking procedure, namely incurring a cost before that cost is included in rates. Therefore, Staff respectfully requests that AWR's Petition be denied.

15 Staff does not object to waiving the initial order on this matter. Staff contacted Mr. Finnigan, counsel for AWR, who indicated he also had no objection to waiving the initial order.

DATED this _____ day of November 2003.

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