BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION

COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

COMPLAINANT,

VS.

RAINIER VIEW WATER COMPANY, INC.,

RESPONDENT.

REBUTTAL TESTIMONY

OF DOUGLAS FISHER

ON BEHALF OF RAINIER VIEW WATER COMPANY, INC.

January 18, 2002

Q. Please state your name and address for the record.

A. Douglas Fisher. My address is 219 S. 115th Street, Tacoma, WA 98444.

Q. Have you previously provided testimony in this matter?

A. Yes. On October 26, 2001, my direct testimony was submitted to the Commission.

Q. What is the purpose of your testimony at this time?

A. I reply to certain adjustments made by Mr. Kermode. I also will discuss the effect that Commission staff's recommendation will have on the operations of the Company, if that recommendation is accepted.

EFFECT OF COMMISSION STAFF RECOMMENDATION

Q. What will be the effect of the Commission staff's recommendation on the Company's operations?

A. Implementation of Staff's recommendations would render the Company unable to meet its obligations to its customers. There is an old adage that those who do not know their history are doomed to repeat it. That would be a shame if it happened in the Commission's treatment of Rainier View. I urge the Commission review Rainier View's history.

Q. Would you briefly describe that history?

A. Rainier View at one time was in very dire financial situation. It was also in a position where there were a large number of customer complaints because the Company did not have the resources to provide adequate service. This situation existed in the late 1980's and resulted in the Company filing rate cases in rapid succession in order to gain some degree of financial viability. Those rate proceedings were ugly. There were literally hundreds of customers that were complaining about quality of their water and the level of service that they were receiving. However, the Company did not have resources to do anything else.

After receiving rate increases, the Company was able to devote those funds to providing better service to the customers. With the leadership of Mr. Richardson and the devotion of the Rainier View employees, service was turned around and over the decade of the 1990's, service improved in every way conceivable. More source and storage were brought online to provide adequate resources. Treatment programs were brought online to better the quality of water. Additional staff were added to address customer concerns in a timely fashion. If you look at the complaint logs as they relate to Rainier View you will see that they decreased dramatically through the 1990's.

The effect of Commission staff's recommendation will be to reverse that trend and put Rainier View in a situation where it will have to layoff employees, defer

capital projects, defer maintenance and slow down its ability to respond to customer concerns.

Q. Why would that be the case if according to Mr. Kermode, Commission staff's recommendation produces an 8.69% return on investment?

A. The key is in the adjustments that are made on the way to that result. Two of the largest adjustments are the removal of the income tax expense and the treatment of the "ready to serve" charges. The Company's regulated operations generate taxable income and there is a real income tax expense associated with its operations. Yet, Commission staff pretends that that expense does not exist. Second, the "ready to serve" charges are a financing mechanism for purchasing rate base, it is not a capital recovery mechanism. It is not money that the Company has available to meet ongoing expenses or to address additional capital projects. It is designed exclusively to be a funding source, not an operating revenue source. These two items are discussed in more detail later in my testimony.

AGREED ADJUSTMENTS

Q. Are there any adjustments on which the Company and the Staff agree?

A. Yes. There are a number of items which I set out in my testimony that Mr. Kermode agreed with in his testimony. In addition, the Company accepts Mr. Kermode's working capital adjustment.

Q. What are those agreed items?

A. The Company and Staff agree on adjustment RA-1 (Company) which is also labeled RA #1 by Staff. The Company and Staff agree with Company's adjustment PA-3, which has been labeled by Staff as PA #2.

The Company and the Staff agree on the materials and supplies adjustment as proposed by the Company, which is PA-6 and labeled by Staff as PA #4.

The Company and Staff agree on the utility plant and service, accumulated depreciation and net CIAC numbers. These are found at lines 43, 44 and 45 of my Exhibit _____ (DF-2) and are labeled by Staff as adjustments RA #14 and RA #15.

Staff has proposed a working capital adjustment, RA #16. The Company will agree with that adjustment.

To the extent that there are minor dollar differences between these "agreed" adjustments, the Company is willing to accept Staff's figures.

Q. Do you know why Commission staff has different adjustment numbers than the numbers used by the Company for the same adjustments?

A. No. It would have much easier to follow the adjustments if Staff had used the same adjustment numbers as the Company and then for their additional adjustments added on the additional numbers. As it is, it is somewhat confusing to try to respond to Staff's presentation when the adjustment labels differ from the Company's labels. This has added to the cost of the Company's work in this case, since we had to go through and figure out which adjustments by Staff correspond to which adjustments by the Company and determine on each individual case whether there was a difference or not. Nowhere in Mr. Kermode's testimony does he indicate where he agreed with the Company on any adjustment. However, he did, in fact, agree on at least a few.

Q. Have you prepared an exhibit which sets out each adjustment proposed for this case and its appropriate number and whether it is agreed or not?

A. Yes. Exhibit_____ (DF-13) does just that. The first column of the exhibit sets out the name of the adjustment, sometimes in shortened form, the second column has the number that Rainier View attached to the adjustment and indicates where it is not an adjustment proposed by the Company. The third column sets out the Commission staff label for the adjustment and also indicates where it is not an adjustment proposed by Commission staff. The fourth column indicates whether

the adjustment is agreed or not. The fifth column sets out the difference between the Company and the Commission staff. Where the adjustment is a flow through from an earlier adjustment or a different adjustment, it is indicated as "flow through" rather than stating a dollar number at this time.

Q. Two of the adjustments are labeled in column four as "partially". Please explain what you mean by that.

A. I used the term "partially" to indicate that the Company agrees with a portion of the Staff analysis. I will explain that situation in more detail as each of those matters are set forth below.

CONTESTED RESTATING ADJUSTMENTS

Q. Do you agree with Mr. Kermode's treatment under his RA # 2?

A. No. Mr. Kermode's treatment might be appropriate if the ready to serve charge was established with the purpose of allowing the Company to recover a return on plant and the cost of depreciation of that plant. However, that was not how the charge was developed and is not the basis for the calculation of the charge. Instead, this charge was put in place as a financing mechanism for the Company when the developer line extension program evolved into a buy-back program to address Commission staff concerns about financial viability of the Company.

Q. Would you please identify Exhibits _____(DF-14) and _____ (DF -15)?

A. These exhibits were compiled in an effort to thoroughly review the history of what the Company has done in conjunction with the Commission on the developer line extension program with the ready-to-serve charge and on the handling of federal income tax expense.

Q. Why did you review the history of these two items?

A. Because they came up as issues in this rate case which, based upon Staff's recommendations, have a substantial negative impact on the Company. Commission staff is reversing of its historical positions on these issues. Because of Commission staff's change of position for purposes of this rate case, the Company felt it was important to back and show the history of these items.

Q. Please explain Exhibit _____(DF-14).

A. Exhibit _____ (DF-14) is a compilation of the Company's contracts under the developer line extension program which began in 1990. It demonstrates the change in the program over time. I will go through that exhibit in more detail later.

One thing that has never changed is that since that program was established in 1990, the Commission has approved the developer line extension contracts with recovery of the income tax expense by the Company directly from the developer.

The Commission did not treat income tax expense as an expense for the shareholders or owners of the Company to incur, but allowed and approved recovery directly from the developers, the customers, themselves. The Commission has been aware that the Company is an S Corporation. That S election was discussed up front with Commission staff.

Q. Please explain Exhibit _____(DF-15).

A. The other exhibit, Exhibit _____ (DF-15) is an exhibit which is compiled from Mr. Finnigan's billing records and notes. Mr. Finnigan has been the Company's primary contact with the Commission. What this exhibit shows, as I will discuss in greater detail, is a consistent review with Commission staff of each and every major change in the way in which the developer line extension program operated.

Q. Please describe Exhibit _____ (DF –14) in more detail.

A. Exhibit _____ (DF-14) is divided by year. It begins with contracts filed in 1990. There are four contracts filed in 1990. Each of these contracts had as its primary objective the recovery of the federal income taxes associated with the donation of the system improvements by the developer to the Company. This was the result of the 1986 tax code amendments which made those donations a taxable event to the Company. This purpose is confirmed by Mr. Finnigan's letter to Mr. Ottavelli of December 13, 1990. See p. 54 of Exhibit ___(DF-14).

Each of these agreements was reviewed with Commission staff and allowed to go into effect. The discussions with Commission staff are evidence not only of the December 13, 1990 letter, but from the meetings and phone calls that Mr. Finnigan had with Staff as evidenced on Exhibit ____ (DF-15) pages 2-14. Please note that early on the program was sometimes referred to as a System Improvement Program and sometimes as a Developer Extension Program.

I should note that when this program was set up, there was extensive discussion about whether or not the income tax expense should be recovered directly from the developer under these contracts or from the general rate payers. It was felt that since in this particular case since the cost-causer could be specifically identified, the tax should be recovered from the developer. That was a position that both the Company and the Commission staff agreed would be the best approach. There was never any discussion that somehow the owners of the Company should bear the responsibility for the federal income tax.

In 1991, the program continued. For example, there is the contract for the Kennedy Extension which was approved on a WSN order. That order states "After careful examination of the Kennedy Extension Contract…and giving consideration of all relevant matters and for good cause shown, the Commission finds that the Kennedy Extension Contract should become effective April

18,1991." Exhibit ____ (DF-14) at p. 63. The primary element of that contract is the recovery of the federal income tax expense.

In 1991, the recovery of federal income tax expense was also discussed with Commission staff in reviewing the Company's annual report. The Company's letter of September 24, 1991 is attached as page 73 of Exhibit ____ (DF-14). During that year there was a substantial change to the developer program to include a charge for a facilities fee. That charge was a subject of much discussion with Commission staff as evidenced from Exhibit ____ (DF-15) at p. 18-23 and the October 31, 1991 letter to Mr. Ottavelli included in Exhibit ____ (DF-14) at p. 75.

Contractual activity picked up in 1992. There are quite a few contracts that were submitted for Commission approval. As indicated on the cover letter to the Magnuson Line Extension, the supporting information for the off-site charge of $600 per residential equivalent was submitted for Commission review. That support was prepared by Pac-Tech (now Apex) Engineering. It is included with the 1992 contracts. See Exhibit____ (DF-14) at p. 77-80.

These contracts, which included the capacity charge or off-site charge, were approved by Commission Orders. See Exhibit _____(DF-14) at p. 83-84; 97-99; 110-112; 122-124. Those Commission Orders expressly recognized that the

Company would be recovering federal income tax from the customer, not that the owner would absorb that charge. Commission staff recommended that the Commission approve the charge, including the recovery of the federal income tax expense. A copy of Staff's memo is also found in Exhibit ____ (DF-14) at p. 112 and 124.

In 1993, there was significant contractual activity. What is also significant in 1993 is that the Commission staff became concerned that the contracts that the Company was entering into were producing a large amount of CIAC and having an adverse effect on the Company's rate base. As a result, the Commission staff requested that the Company explore ideas to increase rate base to address the company's financial viability. The Company committed to do so (see Exhibit ____(DF-14) at p. 197.

As a direct result of that commitment and working with Commission staff, the change to the developer line extension program was added that had the Company purchasing the developer's lots at a Company determined amount ($600 per lot) that represented a fair market value, recognizing that there was a limited market for the improvements that were constructed by the developer. To be able to make the buy-back work when the Company had limited financial resources, the Company developed a financing mechanism that it discussed directly with

Commission staff. That financing mechanism was the development of a ready to serve charge.

The ready to serve charge was calculated so that, on balance, using a five year amortization at a standard purchase price of $600 per connection and an interest rate of 6%, payments by the developer to Rainier View and the payments by Rainier View to the developer would be equal. The theory was that most developers would sell out their lots in about two years. This two year break-even point was based on the Company's experience with developers over time. If the developer sold its lots more rapidly, then Rainier View would pay the developer more money than the developer would pay Rainier View. If the developer was slow to sell its lots, then the converse would apply. But on balance, the program was designed to even out so that the funds coming in from the developers would be used to purchase the property from the developers.

After discussing this concept with Commission staff over several months (see Exhibit ___ (DF-15) at p. 35-46), the buy-back and the supporting ready to serve charge were first incorporated into the Palmer Contract. See Exhibit ___ (DF-14) at p. 269-270 and 275-283. That contract was specifically approved by Commission Order which recognized that there would be a purchase financed over time and at the same time there was a ready to serve charge contained in the contract. See Exhibit ___ (DF-14) at p. 271-274.

As noted in Exhibit _____ (DF-15) at p. 35-46, Mr. Finnigan's records show "viability" issues were discussed on June 7, 1993 with Mr. Ward and Mr. Ottavelli. Mr. Finnigan's letter of June 8, 1993 confirms that discussion. Further discussions occurred on June 9, 1993 with Mr. Ward, Mr. Ottavelli and Ms. Parker. Additional discussion occurred with Mr. Ottavelli concerning the contract process on September 13, 1993. There were further discussions with Mr. Ottavelli on November 18, 1993 and December 9, 1993.

Another problem that the Company faced at that time was that its capital structure was highly leveraged. The Company did not have much equity. The Company was having trouble attracting financing to build new capital projects. In addition, it was not able to meet the Commission tests for being classified as financially viable. As a result, the Company was having difficulty meeting customer needs. This program helped address the capital structure problem as well.

The program continued through 1994 and 1995 largely unchanged from the way in which the Palmer Contract was set up. The Company purchased the developers' assets, funded through the ready to serve charge and therefore increasing its rate base and allowing the Company to become viable.

This program had two salutary effects. It allowed the Company to meet the Commission's test for financial viability. It also allowed the Company to attract CoBank as a lender. With CoBank, the Company has been able to put into place very advantageous financing rates allowing the Company to finance improvements for the benefit of customers.

Q. What ways have the customers of Rainier View benefited from the Company's use of CoBank?

A. The customers have benefited because the Company has been able to get the financing in place to allow it to build improvements. As a result of those improvements, the quality and quantity of water delivered to the customers has substantially improved. As the Commission is well aware, this Company's customer complaint letters are far, far less than they were in the early 1990's.

The second way in which customers have benefited is because CoBank's lending rates are substantially lower than the average commercial lender. This means that the customers' rates have been lower than they otherwise would have been had Rainier View been forced to borrow from Key Bank or another such commercial lender. Commercial lenders typically do not understand private utilities, i.e. they always believe that CIAC, which is on the liability side of the balance sheet, is owed to someone; therefore, it must be used in the ratio's calculating assets to liabitities. Of course, that would always cause problems with the bank auditors

making a timely decision on lending requests. This resulted in loan terms which were typically in the range of five years, with some loans on ten year amortizations five year balloons, when they would lend at all. Rates were bank prime plus 2 or 3 percent.

What did CoBank mean to our customers? CoBank fully understands the key components of rates, rate of return, CIAC and the process for approval of financial contracts with the Commission. But better yet, CoBank offers the utility, whose assets have depreciation lives of 25 to 50 years, minimum lending terms of fifteen years, with longer terms available, and rates usually at close to a commercial bank's prime rate, saving our customers 200 to 300 basis points in cost. This is a substantial savings.

As I stated, the contracts after 1993 were all generally in the form of the Palmer Contract, the last contract of 1993. There have been some minor changes over the years. Perhaps the most significant change was the increase in the amount of the off-site fee. That increase was thoroughly discussed and reviewed with Commission staff before its approval was implemented. Every contract up to and including those filed this year include the recovery of income tax from the developer (the customer).

Very recently, the Company has stopped the "buy-back" portion of the line extension contracts. This is because the Company, at least in its view, has reached a sufficient level of rate base to be able to meet the test for financial viability well into the future, even if there is a growth in CIAC. The Company will evaluate this situation on a year-by-year basis. However, it was felt that it was in the best interest of the Company and the customers to stop the "buy-back" for a period of time.

Please note that the Company stopped including the "ready to serve "charge in the contracts at the same time that it stopped including the buy-back program. If this was a true "ready to serve" concept and not a financing mechanism, the charge would have continued.

Q. Did the Company include ready to serve charges as operating revenue in its last rate case?

A. No. That rate case filing was thoroughly reviewed by Commission staff. It was pointed out to Commission staff at that time that the ready to serve charges were not included in miscellaneous service revenue and were treated as non-operating revenue. Commission staff agreed with that treatment since Commission staff recommended, and the Commission subsequently approved, a rate increase for the

Company treating those revenues as non-operating revenues. See Exhibit ___ (DF-16).

Q. Do you agree with Mr. Kermode's treatment of the recognition of CoBank dividends, Staff RA #3?

A. No. As stated by Mr. Kermode, "GAAP allows the Company to either recognize the income as a direct reduction to interest expense or, as the Company has done, recognize interest income." Exhibit ___ (DPK T-1) at p. 9, l.14-15. The only rationale Mr. Kermode offers for changing from what the Company has done is that it avoids some complications in the cost of capital computations.

As explained by Mr. Ault, the preferred method is the method the Company has used, which is to recognize patronage dividend as interest income. In addition, I have already taken the dividend into account by crediting the interest income in the calculation of interest expense. Mr. Kermode, in essence, double counts this item by not recognizing what the Company has done.

Q. Do you agree with Mr. Kermode's adjustments RA # 4, Mr. Richardson's salary?

A. Emphatically no. This proposed adjustment is an insult not only to Mr. Richardson, but to everyone else who works at the Company. It also starts from a flawed premise.

Q. First, what is the flawed premise?

A. Mr. Kermode treats the salary level from 1993 of $44,721 as though it had not been adjusted to reflect the amount of time Mr. Richardson devotes to Company business. In fact, the adjustment had already been made to arrive at that sum. Therefore, when Mr. Kermode makes a further adjustment to account for the 60% of time devoted to Company business, he is applying the same adjustment twice. Therefore, Mr. Kermode uses the wrong starting point.

In addition, Mr. Kermode capitalizes a portion of the wage for Mr. Richardson. Please note that the amount on my Exhibit _____(DF-2) in the "Per Books" column is already reduced by the capitalized portion of the salary.

Q. Other than this flawed premise, do you have any concerns about Mr. Kermode's adjustment?

A. Absolutely. Mr. Richardson has been the primary mover in making sure that Rainier View became a leader in terms of providing the highest quality customer service. He has led the Company in a direction that the Commission should be proud of. I guess my question to the Commission is that if you penalize owners who pay themselves a salary when they have poor performance and you now penalize the owner who receives a salary when the company has excellent performance, are you sending a message that it just does not matter?

The testimony of Mr. Ault and Mrs. Parker address these issues in greater detail. As shown by Mr. Ault, Mr. Richardson's salary is quite appropriate given the size of the Company and its scope of operations. Ms. Parker shows that Mr. Richardson is modestly paid compared to what other water company owners are paid when the size and complexity of the Company's operations are taken into account.

I want to add a comment here on this issue. The Commission should remember that in 1993, Mr. Richardson was operating a company that was just starting to come out of a period of time where it was in a great deal of trouble and had about five thousand connections. Over the past nine years, Mr. Richardson has placed this company in a position where it has very few customer complaints, millions of dollars have been expended to improve service, and there are now nearly twelve thousand connections.

Just on a per connection basis, Mr. Richardson should be receiving more than what he is being paid. Not the insult that Mr. Kermode would allow. To put it in terms of numbers, we had an average of 5,071 customers in 1993 with a salary of $44,721 or $8.82 per customer. The test year 2000 average customers is 11,097, and with a salary of $76,440 (the portion included in rates), the result is $6.89 per customer and rises only to $7.27 per customer (with the 2000 wage increase). Mr.

Richardson's salary load is less per customer today than it was in 1993. To carry this analysis farther, per books revenues were $1,122,857 in 1993, compared to $3,259,775 in 2000. Mr. Richardson's salary was 3.98% of revenues in 1993, but is only 2.48% of revenues in 2000. Another helpful comparison is rate base. In 1993, Mr. Richardson's allowed salary was 3.83% of rate base. In 2000, it was only 1.60% of rate base.

Q. Are there any other factors the Commission should take into account?

A. Yes. Mr. Kermode argues that Mr. Richardson's increase should be left at the rate of inflation. As pointed out by Mr. Ault, salaries in the Pacific Northwest have increased faster than the rate of inflation. Why should Mr. Richardson be treated any differently than other people in the Pacific Northwest?

In addition, Mr. Kermode makes no allowance for longevity, increased responsibility or increased size of operations.

Q. How does Mr. Richardson's increase compare to other Rainier View employees?

A. Mr. Richardson has never received an annual increase greater than that of the rank and file employees. Each year management sets a range in which the employees will receive an increase and then applies that range to the employees based on their performance, job category, years of experience and other factors. For

example, in one year the rate of increase might be a three to five percent range. Mr. Richardson's salary was always set within the range and very seldom, if ever, at the top of the range.

Q. In your view, what does Mr. Richardson do for the Company?

A. Mr. Richardson does exactly what the president of a company is supposed to do. He provides the leadership for the Company. He sets the tone that allows and creates the working atmosphere that encourages employee dedication. This results in increased customer service.

In addition, Mr. Richardson is responsible for making every major decision for the Company. Mr. Blackman and I report to him on a daily basis. He has ultimate authority for every employee personnel decision, whether hiring or firing, including major employee disciplining decisions. He is ultimately responsible for every financial decision for the Company. He has final operation and financial responsibility for a Company that serves almost 12,000 customers, and has 27 employees and produces over $3,000,000 in operating revenue. He fulfills the responsibilities of president of the Company just as any other president of a company of a similar size would do and should be compensated accordingly.

Q. Do you agree with Mr. Kermode's capitalizing of 15.33% of Mr. Richarson's wage?

A. No. In the past the Company had capitalized a portion of the wage and included that amount in rate base. Mr. Kermode told the Company that the staff would oppose any recovery of salary in rate base. If you look at what Mr. Kermode did, you will see he did not add the capitalized portion of the wage increase to rate base. That means that over 15% of the salary simply disappears as an expense, whether recovered in the current year operations as an operating expense or over time as an addition to rate base. If the Company is not allowed to recover the sums through an addition to rate base, then the entire amount should be recovered as operating expense.

Q. Do you agree with Mr. Kermode's adjustment RA # 5, a portion of the test year's legal expense?

A. No. Mr. Kermode states "it would be unfair to require the rate payers to pay for a case that the Company, on its own motion, withdrew." Exhibit ___(DPK T-1) at p. 10, l.16-17. However, that does not tell the story.

When the Company filed the rate case in 2000, it was not expecting major issues. For the very first time, the Company learned that this Commission staff would propose the adjustments that it is proposing in this case related to the ""ready to serve" charge and the treatment of income taxes. The Company had to begin research on those issues in that case and begin to consider how those issues might affect its filing not only for 2000, but for 2001. Based on the passage of time and

the view that it would be better to prepare a case if the Company went into the case with some work done on those issues, the Company withdrew the 2000 rate case. However, a good portion of the 2000 expense was incurred to prepare for the "ready to serve" and income tax issues. The work that was done in 2000 would simply have had to be repeated this year and increase the current rate case expense. Therefore, it is not appropriate to remove those amounts.

Q. Do you agree with Mr. Kermode's adjustment RA #6?

A. No. The Company discussed with Commission staff what would be necessary for the Company to justify its proposal in this matter. Commission staff suggested that if the Company was able to confirm with real estate brokers in the area that a substitute location would be at or about the same rate that the Company is proposing, then the Commission staff's view is that they would accept the adjustment. This is similar to what was accepted by the Commission in the American Water Resources rate case.

On that basis, I called three real estate brokers in the area who are familiar with commercial property. Those real estate brokers first indicated to me that commercial office space of the size that Rainier View needs is just not available on today's market. This is because the urban growth areas in South Pierce County, which is the area where the Company serves, are very limited. In addition, the existence of the urban growth boundary in the area has brought

commercial office space to almost 100% occupancy. The brokers knew only of small commercial office spaces that are available, which would not be sufficient for Rainier View's needs.

If commercial office space was available in a size sufficient to meet Rainier View's needs, it would be in the range of $15 per square foot. This compares to the $8.75 per square foot Rainier View is now paying under the lease. On an annual basis, if Rainier View were to move, it would pay $85,245 for building rent compared to the $49.740 it pays today, a savings of over $35,000.

Even less likely to be available within urban growth areas in South Pierce County would be commercial office space that has yard space available, which Rainier View needs for its storage of vehicles and inventory. The brokers indicated that there are some pieces of property available that do have yard storage available. When that happens, the storage generally goes in the neighborhood of 10-30 cents per square foot. Using 20 cents per square foot, the total annual rent Rainier View would pay if it moved is $88,245. This compares to the amount that Rainier View is paying of $49.740 (the outside space is included in the total rent paid today), for a savings to the rate payer of almost $40,000.

I sometimes think that the Commission staff forgets that Rainier View tries to manage its operations in the best interest of its customers. This is the type of

adjustment that says to the Company that Commission staff does not trust that the Company is doing. I will relate to the Commission that the Company has considered on occasion whether or not it would make better sense for Rainier View to purchase a piece of property in its own name, so that it could have its operations completely separate. If the current lease rate that is paid by Rainier View were calculated to be an amount that could amortize a debt obligation on a new piece of property, even with favorable financing, we are looking at approximately a loan of $400,000. The sum of $400,000 is woefully insufficient to be able to buy land within an urbanized growth area in Pierce County and build a commercial office building of sufficient size to Rainier Views operations. The customers are far better off by having Rainier View lease its current operations at its current location. The customers are benefiting from this situation.

If Mr. Richardson wanted to maximize his own wealth in this circumstance, he would make Rainier View move and sell his property for commercial development. However, he is not taking that action.

In addition, if you have ever visited the offices of Rainier View, you know that the Company is doing what it can to operate efficiently. Its offices can not under any circumstances be considered palatial or any form of gold plating at the expense of the customer.

Q. Do you agree with Mr. Kermode's adjustment RA #7, vehicle insurance expense?

A. Yes and no. I agree with removal of the 1984 Ford Mercury Cougar. That was an item that should not have been there and was listed as a mistake. The remainder of the adjustment is a flow through related to the type of vehicle that is allowed for Mr. Richardson. I will address that item later.

Q. Do you have any comments on Staff adjustment RA #8?

A. This is simply a flow through adjustment. The result is whatever it will be.

Q. Does the Company agree with Mr. Kermode's adjustments RA #9 and RA #10?

A. No. Those items are covered in Mr. Ault's testimony.

Q. Do you agree with Staff adjustment RA #11?

A. This adjustment is needed only if the Commission accepts Staff recommendation on the "ready to serve" charge (RA #2). I certainly disagree with RA #2. However, I have no disagreement with the way in which RA #11 is calculated if the Commission accepts Staff's RA #2.

Q. Do you agree with Mr. Kermode's treatment of interest income, Staff RA #12?

A. No. That matter is covered in Mr. Ault's testimony.

Q. Does the Company agree with Mr. Kermode's removal of income tax expense, Staff RA #13?

A. No. As I have pointed out above, the Commission has consistently recognized the Company's ability to recover federal income tax expense from the customer. That has been the Commission's consistent treatment since 1990. As pointed out in the testimony of Mr. Ault, Ms. Ingram and Ms. Parker, recognition of federal income tax expense is entirely appropriate.

CONTESTED PROFORMA ADJUSTMENTS

Q. Do you agree with Mr. Kermode's adjustment PA #1?

A. No. The difference between Commission staff PA #1 and the Company's PA-1 is the capitalization of portion of the wage increase. Once again, although Mr. Kermode removes a portion of the salary as capitalized, he does not increase rate base by the capitalized portion. Again, 15% of the wage increase simply disappears.

In addition, the increase for wages granted in December of 2001 is now known and measurable. The Company's consistent practice over the last several years has been to grant wage increases in December of each year. Consistent with that practice, and recognizing increases that the Company committed to grant as part

of an employee retention program, this adjustment should now be increased by $49,914 and payroll taxes should be increased $5,303. Please see Exhibit _____(DF-17).

Also consistent with past practice, Mr. Richardson's increase was not at the high end of the range. Rather, he was granted an increase of 2.62% compared to the actual average for the other employees of approximately 4%.

Q. Do you agree with Staff pro forma adjustment #3?

A. No. There is approximately $26,000 in difference between the Company's original number and the Staff on this adjustment. See, Company adjustment PA-7. The Company agrees with approximately $20,000 of Staff's adjustment. This is because there has been a decrease in the rates that Tacoma City Lights will be charging during 2002. It appears that Commission staff has not taken into account the increase from Peninsula Power and Light. That accounts for the other $6,000 difference. We disagree with that portion of the adjustment proposed by Staff. We believe that the increase from Peninsula Power and Light is known and measurable and should be included in rates. Please see my Exhibit _____(DF-18).

Q. Do you agree with Commission staff adjustment PA-5?

A. No. This adjustment, along with a portion of the depreciation adjustment and Commission staff RA #7 relate to the vehicle used by Mr. Richardson. Mr. Kermode's rationalization for his adjustment is that the Lincoln Navigator is a luxury vehicle and rate payers should not pay for that cost. However, it does not appear that Mr. Kermode has done any comparison of the relative price paid by the Company for this Lincoln Navigator versus other vehicles. Instead, Mr. Kermode simply picks another vehicle out of the Company's records, a Chevy C35, and says that is more appropriate for Mr. Richardson's use. See Exhibit ____(DPK T-1) at p. 12, l.3-6 and l.13-15.

Q. What is the Chevy C35 referenced by Mr. Kermode?

A. It is a one ton pick-up truck. More specifically, it is a one ton cab and chassis. That is, it has no pick-up bed. The Company purchased that pick-up truck for use as a working vehicle. After purchase, that Company added a flat bed and an above-the-cab rack so that the vehicle could be used in the field. Mr. Kermode's choice of the Chevrolet C35 was obviously undertaken without any real investigation. The vehicle that he has chosen is totally inappropriate.

I should add that many times Mr. Richardson's vehicle is used to transport Company personnel to meetings because it can hold up to five adults. Those employees, I think, would object to having to hold on to the edges of a flat bed truck to attend meetings. In addition, by using Mr. Richardson's vehicle in this

way, we save having to reimburse employees for transportation expenses for those meetings.

Even though the cost of the Lincoln Navigator was very reasonable, if there is reticence on the part of the Commission to accept that vehicle simply because of the fact that it is a Lincoln Navigator, the Company is willing to suggest an alternative. I have investigated the cost of a Ford Expedition which is a commonly used vehicle. My Exhibit _____ (DF-19), incorporates that cost and sets out the figures that would be used for vehicle insurance, both for the test year and as a pro forma adjustment, and the depreciation expense associated with the use of that vehicle rather than the Lincoln Navigator.

Q. Do you agree with Commission staff's handling of rate case expense in their proposed adjustment PA #7?

A. No. Mr. Kermode says that the Company's original estimate for rate case expense should be used. He offers no justification for his adjustment other than his unsupported opinion that he thinks that the new estimate by the Company is excessive. Exhibit ___ (DPK T-1) at p. 23, l.21-26. However, it is always the case that the closer you are to an event the more accurate your estimates will be. Therefore, the Company's number under PA-4 should be used. In fact, we now believe that we will exceed the number we have included for rate case expense as

set out in my direct testimony. I have included the latest estimate with this filing. See Exhibit ____ (DF-22) at p. 5.

Q. What is driving the level of rate case expense?

A. Commission staff has proposed some unique adjustments in this case. The Company believes it was following what Commission staff wanted it to do in the treatment of ready to serve revenue. From the Company's perspective this is a reversal of the Commission staff's position. The Company has had to do a great deal of meticulous research in attempt to reconstruct how the developer line extension program evolved.

Another factor is the Commission staff's recommendation on federal income tax treatment. Again, this is a complete reversal of the treatment of this expense. As the Company has demonstrated, the Commission has allowed the Company to recover federal income tax expense from customers consistently since 1990. There has never been a whisper that because the Company was an S Corporation it should not recognize a federal income tax expense recoverable from customers related to the fact that the regulated operations generate a federal income tax obligation. This again has caused the Company to have to go back and do research on this issue in substantial detail given the size of the effect that this adjustment has on the Company.

In addition to these two very major adjustments, which in and of themselves will determine whether or not the Company is entitled to a rate increase, there are a substantial number of adjustments that Staff is proposing and which the Company had to develop responses to and state its position with supporting detail. This is a highly contested matter.

Finally, the Company is really fighting for its financial life. The Commission staff proposal has no basis in real world operations. If the Commission staff's proposal is adopted, this Company will be on a fast downward spiral to being unable to meet quality of service for its customers and a substantial increase in customer complaints. The Company has had no choice but to put forth the best case it can. That means a substantial rate case expense.

The way the Staff has approached this case has also contributed to the costs. For example, such simple things in Mr. Kermode's testimony as indicating where he agreed with the Company and perhaps using the Company's own numbers for restating and pro forma adjustments and then adding his own adjustment numbers would have simplified the review of Mr. Kermode's testimony and saved some hours among the Company's consultants in having to figure out exactly where Mr. Kermode was headed. In addition, the Company, in attempting to research these issues, made a fairly simple public records request. The response to that public records request was for the Commission to say come look at our files. This added

substantial number of hours to the Company's case by having to have its attorney go through files on a page-by-page basis to earmark the result of operations that were requested. The request was simply for results of operation pages from other water company rate cases in the past three years. Instead of pulling those results of operation pages, the Commission staff forced to Mr. Finnigan to have to leaf through hundreds and hundreds of pages simply to earmark results of operation pages so that they could then be copied.

In addition, because of the importance of some of these issues the company has been forced to hire additional experts, beyond what it had originally estimated. That adds substantially to the cost. I believe it is important to know that based on the origial rate request, the rate case costs are now approaching close to 30% of that figure.

In passing, we agree the portion Mr. Kermode's adjustment PA #7 that removes $3,500 related to the mailing cost. The Company agrees that there is a rate case mailing included in the per books numbers. There may be some differences in cost because of growth. However, that is not a substantial difference.

Q. Please comment on Mr. Kermode's proposed adjustment PA #8, bad debt expense.

A. Mr. Ault provides the primary response on behalf of the Company. I simply will note that the bad debt expense that we have included is consistent with the Company's experience. The Company serves an area with a fairly mobile population. The Company's operating area is just north of Ft. Lewis and McChord Air Force Base and just south of Pacific Lutheran University. As a result, there is a fairly high turnover in renters of apartments, duplexes and homes. Because the Commission's rule prohibits the Company from assessing the landlord for this expense, the Company has been saddled with a relatively high bad debt expense. Taking the past five years beginning with 1996, the Company has an average of bad debt to revenues of 1.45%. In 2000, bad debt was 1.73% of revenues.

The reason that the 2000 calendar year bad debt was not booked in 2000 is that the Company went through a major billing system conversion. This caused some problems in collecting the data. However, the actual bad debt expense in 2000 was only slightly higher than the average over the past five years at 1.73% of revenues.

Q. Do you agree with Commission staff adjustment PA #10?

A. No. Mr. Kermode has used an unrealistic interest rate for the CoBank loans. He uses 5.25%, which is a rate the Company paid to CoBank in the month of

December, 2001. This is the first time the rate was at that level and cannot be expected to remain that low.

It is expected that in 2002 rates will trend up, and it would be much more realistic to use a 7.0% interest rate as an average rate that will be in effect in 2002. In 2001, interest rate paid to CoBank varied between 9.75% and 5.25% and if you average the rate paid in 2001, you would end up with a average rate of 7.42%.

Q. Mr. Kermode testifies that the Company's proposed adjustment PA-10 should not be adopted, do you agree?

A. No. Mr. Kermode argues that this adjustment is not appropriate as a pro forma adjustment.

However, as Mr. Kermode knows, the Company was not able to meet its financial debt ratio requirements with CoBank for the first half of 2001. The Company is suffering through a very severe cash flow crisis. In the middle of that crisis, the Company had to engage in a substantial piece of litigation at the Commission, which was ultimately settled. However, that litigation had the potential to upset the way in which water is allocated in the Company's largest system, Southwood/ Sound. It potentially jeopardized the delivery of a 4.5 million gallon storage tank that will help the Company meet customer demands for water in the summer months. Based on the claims made by the petitioners in that matter, there

potentially could have been even more substantial costs incurred in defending against protracted litigation and ultimately hundreds of thousands of dollars in damages. This cost was prudently incurred by the Company. Indeed, Mr. Kermode does not argue that there is any prudency issue here. It is a known cost that is not offset by their factors and meets the definition for a pro forma adjustment contained in Commission rule.

I note that in a similar situation North Bainbridge was allowed an adjustment to recover this type of loss over five years. See, e.g. UW-000546. The Company would agree to a three-year amortization with carrying costs. Please see Exhibit _____ (DF-20).

Q. Do you have any comments on Mr. Kermode's calculation of return for the Company?

A. Yes I do. I agree with Mr. Kermode that I inadvertently did not include all of the developer debt. However, as I stated above, I strongly disagree with his change in the debt rate for CoBank to the December of 2001 rate of 5.25%. I believe that rate will substantially understate the rate that is needed to be paid by Rainier View in 2002. I have calculated what I believe is the appropriate rate of return on Exhibit ___ (DF-21).

Q. Would you please explain the capital structure used on Exhibit ___(DF-21)?

A. I am proposing we use a hypothetical capital structure of 50 percent debt and 50 percent equity. The Company and the Staff disagree on the calculation of the actual capital structure. To try to simplify this case, at least a little bit, I propose the hypothetical capital structure be used since it is the balance of safety and economy the Commission seeks.

Q. Please summarize the Company's position.

A. I have set out a revised results of operations which takes into account the modifications where I agree with Commission staff's analysis, the adjustment to wages to reflect the 2001 wage increase and other adjustments I discuss above. That results of operations is set out as Exhibit ___(DF-22). This analysis shows that the Company is in need of a rate increase of $448,893.

Rainier View is proposing an increase which is probably less than the rate of inflation since its last increase. Rainier View has done a very good job in controlling costs and operating in an efficient manner. Rainier View has had excellent customer service and has gone out of its way to meet customer needs.

At the same time, as Commission staff is aware, the Company is in a cash flow crisis (even though it is not reflected in this rate case because the test year is 2000). That cash flow crisis results in part from customers increasing their conservation efforts, which the Company is urging them to do, and a cool summer

which cut usage even further. If there is a decrease in usage, there is a decrease in revenue to the Company. At this critical juncture, Commission staff is raising very substantial issues and, to the Company's mind, reversing its position on some critical items. The Company just does not understand why Commission staff is forcing these issues at this point in time.

Q. Do you have any possible solutions to some of these issues?

A. As to the federal income tax issue, I think that the Commission must recognize that the regulated operations of the Company generate a tax obligation and that it is perfectly equitable for rates to the customers to include a component to recover the federal income tax associated with the obligation generated by those regulated operations. This has been the Commission's consistent position in the past and it should be its position going forward.

On the ready to serve issue, the Company went into that program primarily in an effort to benefit the customers it serves. It was undertaking, at Staff's urging that the Company do something, to increase its rate base. It calculated the ready to serve charge on the basis of an investment model, not as a recovery of capital model. Even the name was chosen not because it reflected what was actually done, but because the developers did not like the first names the Company suggested, such as "buy-back charge" or "developer development charge." A couple of the developers have been paying ready to serve charges to some of the

water districts in the area and suggested that we use the ready to serve label as a convenient name. It had nothing to do with the actual purpose of the charge. In any event, Rainier View suggests that the Commission spell out the rules under which that such a program can occur and apply those rules on a prospective basis. Then, if a company wishes to enter into that program in the future, it can calculate the charge to reflect how it is going to be treated. If the Commission wishes to treat the charge as an operating revenue stream in the future, then the company that may wish to enter such a program could make that decision knowing how it will be treated and whether or not it makes sense to do so under that treatment. So, Rainier View's proposal is to allow treatment of the charge for rate making purposes in this case just as Rainier View has proposed. However, have the Commission spell out rules under which such a program would operate in the future and apply those rules on a prospective basis.

I have suggested a compromise on the vehicle issue, which is discussed above.

As to Mr. Richardson's salary, the Company asks that the Commission recognize the value Mr. Richardson adds to the Company and the success that he has brought to the Company to date in meeting customer needs and providing excellent customer service.

On all wage adjustments, the Company is willing to capitalize an appropriate portion of the wages, so long as the capitalized portion is recovered in rate base. The Company is not willing to capitalize wages if the capitalized portion simply disappears.

Q. Please summarize the Company's position.

A. The Company is in need of a rate increase of $448,893. This increase is reasonable and conservative. It will allow the Company to continue to provide high quality service to its customers at reasonable rates.

Q. Does that conclude your written rebuttal testimony?

A. Yes.