

JUL 14 1992

NOTE! An important notice to parties about administrative review appears at the end of this order.

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

|  |   |                           |
|--|---|---------------------------|
| WASHINGTON UTILITIES AND<br>TRANSPORTATION COMMISSION, | ) |                           |
|  | ) | DOCKET NO. UW-911041      |
| Complainant,   | ) |                           |
|  | ) | SECOND SUPPLEMENTAL ORDER |
| vs.  | ) |                           |
|  | ) | FINDINGS OF FACT,         |
| ALDERTON-MC MILLIN WATER<br>SYSTEM, INC.,              | ) | CONCLUSIONS OF LAW        |
|  | ) | AND INITIAL ORDER         |
|  | ) | REJECTING TARIFF FILING   |
| Respondent.  | ) | AND AUTHORIZING REFILING  |
| .....  | ) |                           |

PROCEEDINGS: Alderton-McMillin Water System, Inc. ("respondent" or "company") filed in this cause on September 13, 1991, tariff revisions designed to effect a general increase in its rates for water service in this state of approximately \$172,000 annually. The Commission suspended this filing, Docket No. UW-911041, on October 31, 1991.

The company requested interim rates of \$45,669 annually pending final Commission action on this general rate filing. The Commission heard testimony on the interim request on April 16, 1992. The request for interim rates was denied by the Commission by order entered on June 3, 1992.

HEARINGS: Following a prehearing conference held on December 19, 1991, hearings in the above matter were held in Olympia on February 18, April 13, 14 and 16, and May 26, 1992, before Administrative Law Judge Elmer E. Canfield of the Office of Administrative Hearings. Members of the public testified at the public hearing held in McMillin on April 16, 1992.

APPEARANCES: Alderton-McMillin Water System was represented by Robert E. Lundgaard, Attorney at Law, Olympia; the staff of the Commission by Robert E. Simpson, Assistant Attorney General, Olympia; and the public by William A. Garling and Charles F. Adams, Assistant Attorneys General, Public Counsel Section, Seattle.

SUMMARY: The Administrative Law Judge proposes that the company be authorized to file tariff revisions which will provide additional annual revenues not to exceed \$79,690. The tariff revisions filed by respondent on September 13, 1991 should be rejected.

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## I. SCOPE OF PROCEEDINGS

### A. Procedural History

On September 13, 1991, respondent filed tariff revisions designed to effect a general increase in its rates for water service in this state of approximately \$172,000 annually. The Commission suspended this filing on October 31, 1991. In its complaint and order suspending, the Commission also alleged violations under RCW 80.28.030 and RCW 80.28.040 relating to the purity, quality, volume, and pressure of water supplied by the company to its customers, as well as relating to the rules, regulations, measurements, practices, acts, and services of the company.

Following hearings on the company's request for interim rates, the Commission entered an order on June 3, 1992, denying the interim rate petition.

In another docket (UW-910563, et al.), the company made a surcharge filing under RCW 80.28.022. This filing was rejected as not being in the public interest.

### B. Background of the Company

The respondent, Alderton-McMillin Water Supply, Inc., is a water company located in Pierce County. It is comprised of 14 separate water systems and serves approximately 1,300 customers in Pierce County. Alderton-McMillin has been owned by Dennis Ridgway and his wife since 1981. The respondent was a sole proprietorship for almost 50 years until it became incorporated in 1963. Dennis Ridgway is President, General Manager and is on the Board of Directors. Mr. Ridgway is in charge of the company, including the day-to-day operations. He is one of three employees. The other two consist of: 1) his wife, who works as a part-time secretary, and 2) a maintenance technician.

### C. Evidence

The company in its direct case presented testimony and exhibits of Dennis Ridgway, President and General Manager, as well as testimony and exhibits of James D. Bacon, a self-employed Certified Public Accountant. Mr. Bacon testified on the areas of pro forma results of operations, average rate base, revenue requirement, tariffs and rate of return of the company for the year ending June 30, 1991.

The Commission Staff presented testimony and exhibits of: Fred J. Ottavelli, WUTC Water Program Manager; James M. Owens, President and Lab Director of Laucks Testing Laboratories, Inc.; Teresa C. Osinski, WUTC Policy Research Specialist; Julia M.

Parker, WUTC Revenue Requirements Specialist; and Ellie Reynolds, WUTC Utility Tariff Administration Specialist.

Public Counsel presented testimony and exhibits of Kevin M. Winters, Public Counsel Utility Policy/Rate Analyst, Office of the Attorney General, Fair Practices Division, Public Counsel Section.

Customers gave testimony at the public hearing held in this matter on April 16, 1992. Written submissions from ratepayers were also provided to the Commission.

On rebuttal, the company provided additional testimony and exhibits from Dennis Ridgway and James Bacon, as well as testimony from Michael Heath, a Public Health Advisor with the Washington State Department of Health, Division of Drinking Water, Technical Service Section.

## II. ISSUES AND GOVERNING PRINCIPLES

The ultimate determination to be made by the Commission in this matter is whether the rates and charges proposed in respondent's revised tariffs are fair, just, reasonable and sufficient pursuant to RCW 80.28.020. These questions are resolved by establishing the fair value of respondent's property in service, determining the proper rate of return permitted respondent on that property, and then ascertaining the appropriate spread of rates charged various customers to recover that return.

The purpose of a rate proceeding is to develop evidence from which the Commission may determine the following:

- (1) The most appropriate test period, which is defined herein as the most recent 12-month period where income statements and balance sheets are available. The test period is used for the investigation of the company's operations for the purposes of these proceedings;
- (2) The company's results of operations for the appropriate test period, adjusted for unusual events during the test period and for known and measurable events;
- (3) The appropriate rate base which is derived from the balance sheets of the test period. The rate base represents the net book value of assets provided by investors' funds which are used and useful in providing utility service to the public;

- (4) An appropriate rate of return the company is authorized to earn on the rate base established by the Commission;
- (5) Any existing revenue deficiency; and
- (6) The allocation of the rate increases, if any, fairly and equitably among the company's ratepayers.

RCW 80.04.130 places the burden of proving that a proposed increase is just and reasonable upon any public service company proposing such an increase.

III. TEST PERIOD

The twelve months ending June 30, 1991 is the period for which the most recent and most complete information was available. This test period was used by all the parties as the basis for analysis of the company's performance and condition. The twelve-month period ending June 30, 1991 is found to be the appropriate test period for examination of the company's operations for the purposes of this proceeding.

IV. RESULTS OF OPERATIONS

A. Legal Principles

Having determined the appropriate test period for this case, the Commission must analyze the company's test year operations. The company's Net Operating Income (NOI) per books for test period operations is \$38,279. The booked results of the company's test period operations must be adjusted to remove amounts which are not representative or which are not properly included with the test period. This type of adjustment is called a "restating actual" adjustment. Additional adjustments are then made to test period results to give effect to known and measurable changes which are not offset by other factors occurring during or after the test year. These adjustments are called "pro forma" adjustments.

The company and Commission staff made restating actual and pro forma adjustments based upon their respective exhibits pertaining to the financial data of the company during the test period (company Exhibit No. 10, staff Exhibit No. 31). Public counsel did not do an accounting review of the company's finances. In its brief, Public counsel recommended that the Commission adopt the restating and pro forma adjustments proposed by Commission staff witness Julia Parker in Exhibit No. 31.

Table I compares the results of operations as proposed by the company and Commission staff. Some of these figures have been updated to reflect changes made at hearing and/or on brief.

TABLE I

ALDERTON-MCMILLAN WATER SUPPLY, INC.  
Results of Operations  
Comparison of Parties' Positions  
12 Months Ended June 30, 1991

| Adjustment-Description           | <u>Company</u>    | <u>Staff</u>      |
|----------------------------------|-------------------|-------------------|
| Net Operating Income-Actual      | \$38,278          | \$38,279          |
| Uncontested Adjustments:         |                   |                   |
| RA-3 Misc. Tax Adjustment        | \$855             | \$858             |
| RA-5 Insurance Expense           | 1,104             | 1,104             |
| RA-6 Federal Income Tax          | (903)             | (903)             |
| RA-8 Other Water Revenue         | 3,018             | 3,018             |
| RA-10 Telephone Service          | 2,155             | 2,155             |
| PA-3 Purchased Water             | (2,740)           | (2,740)           |
| PA-4 Underground Locate Service  | (356)             | (354)             |
| PA-5 Property Taxes              | (739)             | (728)             |
|                                  | <u>\$2,394</u>    | <u>\$2,410</u>    |
| Total Uncontested Adjustments    |                   |                   |
| Contested Adjustments:           |                   |                   |
| RA-1 Contractual Services        | 0                 | 10,366            |
| RA-2 Captialized Attorney Fee    | (4,622)           | (6,027)           |
| R-2 Prior Year Rate Case Expense | (446)             | 0                 |
| RA-4 Salaries                    | (16,451)          | (11,490)          |
| RA-7 Accounting Fees             | (2,975)           | 1,253             |
| RA-9 Restate Testing             | 0                 | 1,249             |
| RA-11 Restate Ratebase           | 0                 | 3,850             |
| RA-12 Revenue Imputation         | 0                 | 863               |
| RA-13 6446 Filing Expense        | 0                 | (1,163)           |
| PA-1 Salaries and Fringes        | (25,456)          | (24,995)          |
| P-3 Health Insurance             | (3,631)           | 0                 |
| P-2 New Truck                    | (8,115)           | 0                 |
| PA-2 Management Fees View Royal  | 0                 | 6,817             |
| P-5 Retirement Plan - IRA        | (5,490)           | 0                 |
| PA-6 Rate Case Expense           | (20,400)          | (3,967)           |
| PA-7 Water Mains                 | (2,102)           | (203)             |
| P-9 Unanticipated Expense        | (4,250)           | 0                 |
| P-10 Water Tank                  | (309)             | 0                 |
| PA-8 Pro Forma Debt              | 0                 | (1,098)           |
|                                  | <u>(\$94,248)</u> | <u>(\$24,545)</u> |
| Total Contested Adjustments      |                   |                   |
| Total Adjustments                | <u>(\$91,854)</u> | <u>(\$22,135)</u> |
| Pro Forma Net Operating Income   | <u>(\$53,576)</u> | <u>\$16,144</u>   |



## B. Uncontested Adjustments

The uncontested adjustments in the above table have been examined by the Administrative Law Judge and found to be proper for ratemaking purposes. Staff's numbers are adopted. The minor differences are insignificant.

## C. Contested Adjustments

The contested adjustments will be discussed individually below. For a discussion of Adjustment RA-11 (Restate Ratebase), Adjustment P-10 (Water Tank) and Adjustment PA-7 (Water Mains), please refer to the appropriate heading under Rate Base, Section V.

### 1. Contractual Services, RA-1

Commission staff proposed this adjustment to remove from contractual services those amounts paid in the test period relating to expenses not normal to the test period. These removed expenses include attorney fees associated with the Pierce County hearings, prior rate case costs and costs associated with this rate case and those associated with the "6446 surcharge" filing (UW-910563, et al.). These expenses were then dealt with in other adjustments (RA-2, RA-13 and PA-6). The company's prior year rate case expense, Adjustment R-2, will also be covered later.

The company capitalizes similar costs prior and subsequent to the test period. Capitalization of these out-of-test-period amounts without similar treatment for the in-test-period amounts is inappropriate. The approach suggested by staff will be adopted in this case, thus, staff's proposed RA-1 adjustment is accepted.

### 2. Capitalized Attorney Fees, RA-2

This adjustment corresponds with the company's adjustment R-1, wherein the company adjusted the prior year's attorney fees of \$16,315 for the Pierce County water main looping hearings and amortized it over three years. The company put one year of amortization, \$5,428 into its operating revenue deduction and capitalized the balance into rate base. In staff's proposed adjustment RA-2, it recommended that this cost be amortized over 3 years, but that the balance not be included in rate base.

The company proposes to capitalize and amortize costs incurred prior to the test period. The company's method is rejected. Staff's adjustment, coupled with Adjustment RA-1, capitalizes all attorney fees associated with the Pierce County hearings, and amortizes them over a three year period. The Administrative Law Judge accepts the staff's RA-2 position, except for the rate base treatment, which will be discussed below.

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staff's position in RA-1 with respect to the test period deferral of these legal expenses has been accepted. It is appropriate to accept staff's level of amortization. This cost will be amortized over 3 years.

The company argued that the unamortized portion of these costs represents an investment by the owners and that such costs should be included in rate base. The staff argued that the unamortized portion should properly be included in miscellaneous deferred debits and that rate base inclusion would be as part of investor supplied working capital. Staff's witness testified at Transcript pages 531 and 532 that no working capital existed, thus, no working capital adjustment was made to rate base. However, on brief, staff acknowledged that additional evidence, not included in this record, would have shown a positive working capital.

Staff's accounting for Adjustment RA-2 is appropriate, i.e., the unamortized portion should be debited to miscellaneous deferred debits. Staff also correctly noted that this item would appropriately be included in the company's working capital had there been any. Staff now concedes that a positive working capital exists. Accordingly, the Administrative Law Judge concludes that it would be appropriate to include the unamortized portion of these expenses, net of tax, as an adjustment to rate base in this case. It is pointed out that the company should have commenced amortization at the conclusion of the Pierce County proceedings; it would not be appropriate to delay the start of amortization to the date of the Commission order in this matter.

### 3. Prior Year Rate Case Expense, R-2

In this proposed adjustment, the company recommended that its prior year rate case expense of \$1,575 be amortized over 3 years at \$525 per year, with the unamortized portion being placed into rate base. An amount of \$536 in legal expense was identified as being associated with this prior rate case filing, but it was not clear whether this was included in the \$1,575 or whether it was in addition to it. To resolve this, the Administrative Law Judge accepts the company's amount of \$1,575 as the total amount. In that the company ultimately withdrew this prior filing, Commission staff took the position that this expense was unwarranted; staff proposed deleting this expense entirely as being imprudent. The company argued that these costs were prudently incurred and that they should be allowed to be recovered in a fashion consistent with prior treatment of rate case expense, with deferral and three year amortization.

This record did not establish that the prior year rate case expense was imprudent. The company withdrew its filing when staff recommended no increase. Although it did not agree with the position of staff, the company withdrew its request because it did

not have the funds to pursue the rate increase. Under these circumstances, the Administrative Law Judge finds that this cost was prudently incurred. The company's Adjustment R-2 is accepted. This expenditure is to be amortized over three years. Staff's Adjustment RA-1 was accepted above and the removal of costs in said adjustment should be noted as it relates to this item.

The rate base discussion in the capitalized attorney fees adjustment applies also to the rate base treatment of this item. A rate base adjustment will be made. As with the prior adjustment, it would not be appropriate to delay the start of amortization to the date this rate case is decided; the Administrative Law Judge rules that amortization of this item should have begun upon withdrawal of the tariff filing.

4. Salaries, RA-4

During the last several months of 1990, the company did not pay out the standard wages to its president and secretary due to a lack of cash. In this adjustment, the company adjusted these booked salaries to bring the levels up to the standard wage levels. Staff did not disagree with this approach, but proposed that a portion of management salaries be capitalized as a cost of plant. The company argued against the capitalization since it reduces the cash flow of the company.

The Administrative Law Judge determines that it is a common and required practice to capitalize salaries associated with capital improvements, the company's cash flow argument notwithstanding. Accordingly, staff's proposed Adjustment RA-4 is accepted.

5. Accounting Fees, RA-7

The company proposed a \$3,500 adjustment for the preparation of the company's 1990 federal income tax return and financial compilation. Commission staff did not question the need for such service, but disputed the booked amount and the company's inclusion of an additional \$3,500. Commission staff pointed out that imbedded in the test period is \$4,974 for accounting services; it argued that the company's adjustment erroneously included an additional \$3,500, which amounts to a double recovery. Commission staff witness Julia Parker explained that staff's adjustment adjusts the expense that is in the per books results to the level that the company identified as normal.

The record does not establish exactly what is included in the \$4,974 amount. It was not shown whether the \$3,500 is an additional cost to be incurred by the company or whether it is included in the \$4,974. The \$3,500 figure itself is not well documented as it relates to the total accounting fees required on

an annual basis. However, the evidence did not establish that any portion of the \$4,974 of accounting fees was imprudent or out of period expense. Under these circumstances, the Administrative Law Judge is not convinced that either of the proposed adjustments is appropriate. The company's adjustment may well result in a double recovery. On the other hand, staff's adjustment may remove legitimate expenses. Accordingly, the Administrative Law Judge rejects both the company Adjustment R-7 and staff's Adjustment RA-7 and concludes that no accounting fees adjustment be made in this case.

6. Restate Testing, RA-9

In this adjustment, Commission staff decreased the company's per books expense relating to testing costs to an amount that is normal to the test period. Staff witness Julia Parker noted that the \$4,862 total amount expensed for testing the quality of water overstated the actual amount of testing that was actually done during the test period, as well as what was required by the Department of Health in WAC 246-290-300. Staff determined that the normal amount of expense for tests would be \$3,393 annually; it thus proposed an adjustment of \$1,469 to reduce test period expense to this normalized annual amount. The company cross-examined Ms. Parker on this adjustment, but did not rebut it nor argue it on brief.

The staff's proposed Adjustment RA-9 is reasonable. The adjustment removes out-of-period expenditures and restates test year expenses to actual levels, plus mandatory requirements. The Administrative Law Judge accepts staff Adjustment RA-9.

7. Revenue Imputation, RA-12

Commission staff witness Ellie Reynolds discovered that the company had under-billed some of its mobile home customers during the test period. Based on her investigation, she recommended a \$1,071 adjustment to bring the revenue level up to tariff rates. The company did not rebut this adjustment, nor did it address it on brief.

The company is prohibited under RCW 80.28.100 from charging greater or less compensation for water service than the tariff rate. The RA-12 adjustment is proper and is accepted.

8. 6446 Filing Expense, RA-13

In Docket No. UW-910563, et al., the company made a surcharge filing under RCW 80.28.022 (Section 6 of SSB No. 6446). Commission staff's Adjustment RA-13 takes the 6446 expense and amortizes it over the term of the proposed surcharge.

Staff's approach to the handling of these expenses is found to be reasonable. It was not rebutted by the company. Accordingly, staff's proposed Adjustment RA-13 is accepted.

9. Salaries and Fringes, PA-1 (Company P-1, P-3 & P-5)

In its Adjustments P-1, P-3, and P-5, the company made adjustments for a new employee (P-1), health insurance for the new employee (P-3) and a retirement plan (P-5) for all employees. The parties agreed that the company is understaffed and a new employee is needed, but Commission staff used a different approach.

In its Adjustment PA-1, Commission staff proposed to increase the company's expenses for salaries, combined with fringe benefits. It determined that \$105,120 is the total amount needed for salaries, insurance, retirement and other benefits; this amount is adopted in this order. However, in its adjustment, staff also proposed an increase in rate base of \$3,977; this portion of the adjustment is rejected, as discussed below.

Care must be taken in making pro forma adjustments concerning the adding of a new employee. This is not typically the type of situation where pro forma wage adjustments are seen. However, upon review of the poor level of service that has been provided by this company, the Administrative Law Judge concludes that such an adjustment is appropriate in this case; the evidence has demonstrated the company's inability to provide satisfactory service without a new employee.

The rate base portion of Adjustment PA-1 was not supported by evidence. The Commission looks at historical costs as the basis for rate base. It is not usual regulatory practice to pro form rate base for the impact of future expenditure levels. There is also the requirement that rate base must be used and useful. Furthermore, offsetting factors would need to be considered. While it is true that a portion of the wages will be capitalized in the future, this may be offset by CIAC, growth in customer base or accumulated amortizations. Staff's proposed rate base treatment is not proper. One cannot assume that an expenditure was made when it never will be. In this situation, the ratepayer is not receiving the benefit of such costs. Accordingly, the rate base portion of Adjustment PA-1 is rejected.

In allowing an adjustment for increased salaries as discussed above, the possibility arises that such an adjustment may help the company without a corresponding benefit to the ratepayer, i.e., after receiving the additional revenues, the company may elect not to follow through on hiring the new employee. In reviewing such matters, it is always important to keep in mind that the public interest requires a weighing of the interests of the

company and the ratepayers. In WUTC vs. Pacific Beach Water, Inc., Docket No. U-89-2953-T (Apr., 1990), the Commission stated:

Respondent as a regulated public service company has the responsibility under RCW 80.28.010 to "...furnish and supply such service, instrumentalities and facilities as shall be safe, adequate and efficient, and in all respects just and reasonable." That section also provides that charges made, demanded or received "...shall be just, fair, reasonable and sufficient." In this regard, the need of the company for additional funds must be balanced against the concerns of customers that money tendered for services rendered be used in a prudent manner.

The Administrative Law Judge thus proposes that, except for the rate base portion already rejected, staff's Adjustment PA-1 be accepted with the clear expectation that the new employee in fact be hired within 30 days of the Commission's final order in this matter. The company shall follow through on such hiring and provide the Commission with appropriate supporting documentation. Commission staff shall monitor the situation and should file a complaint if the company fails to comply with the terms of this order.

Acceptance of Adjustment PA-1, as discussed above, resolves the related adjustments of the company. Accordingly, company Adjustments P-1, P-3, and P-5 are rejected.

10. New Truck, P-2

In this adjustment, the company initially included \$32,000 for the purchase of two new trucks. Its present truck is old and is in need of major work; as of the company's rebuttal hearing, this truck was inoperable and the repair costs exceeded its value. The company was temporarily using an employee's truck. The other truck included by the company in this adjustment was the cost of a new truck for a new employee, who has not yet been hired.

Commission staff proposed that there be no allowance for trucks. It did not dispute that the company needs two working trucks, but argued that the company's pro forma adjustment does not meet the criteria of known and measurable. Staff questioned the prudence of purchasing two new trucks. It suggested other options such as leasing, paying mileage for use of an employee's truck or purchasing used trucks.

On rebuttal, the company changed its approach and announced its intention to lease two new trucks. It presented

several purchase and lease options that it has considered. Mr. Ridgway was inclined toward the 60 month lease with no residual, but had not yet signed such a lease. Mr. Ridgway explained that the company's actions are subject to what the Commission does in this rate case.

The Administrative Law Judge concludes that the cost of one truck should be allowed. Consistent with the above Adjustment PA-1 wherein the salary of a new employee was included, a vehicle for this new employee should be included. The cost is now capable of being measured by reference to the lease documents. Of the two referenced vehicles, the one that would correspond to the new employee is determined to be the less expensive GMC pickup. As indicated above, the company has decided to go with the 60 month lease, with a zero residual. Such an adjustment as calculated below should be accepted. The Administrative Law Judge is of the belief that the lease is a capital lease and should be booked appropriately. For this case, we will expense the lease as a reasonable approximation of these costs.

The same problem exists with this adjustment for a new truck as with the new employee adjustment (PA-1): how to make sure the increased revenues are used for the intended purpose. The same approach will be proposed by the Administrative Law Judge. The company is to follow through on its commitment to lease the GMC pickup for the use of the new employee within 30 days of the Commission final order and shall provide appropriate supporting documentation to the Commission. Commission staff should pursue a complaint against the company if it fails to comply with the terms of this order.

The pro forma adjustment for the second truck to replace the existing truck is rejected. It does not meet the criteria of being known and measurable not offset by other factors. What is being replaced is not really known. Also lacking is information on offsetting factors.

#### 11. Management Fees View Royal, PA-2

Mr. Ridgway confirmed that the company provides all normal operating duties for View Royal Water Company, an affiliated company. The company's time records are inadequate, thus the amount of time spent in providing these services for View Royal was not readily ascertainable. Commission staff used the same study used in adjustment PA-1 to impute the associated revenues from View Royal customers. The company did not rebut this adjustment or directly comment on brief.

This adjustment is intended to avoid cross-subsidization of View Royal customers. It allocates management costs to View Royal Water. This adjustment is proper and is accepted.

12. Rate Case Expense, PA-6

The company's original Adjustment P-6 included \$14,000 as the current cost of this rate case. It proposed that this amount be expensed in total rather than being amortized over a period of time. In staff's Adjustment PA-6, staff took the company's \$14,000 rate case cost estimate and amortized it over a three year period, similar to its treatment of capitalized attorney fees in Adjustment RA-2; staff proposed to not include the balance in rate base.

On rebuttal, the company updated its rate case expense to \$24,000. This total amount was included by the company in its prefiled rebuttal testimony. Mr. Bacon's rebuttal testimony underwent cross-examination. Although a three year amortization might be acceptable to the company, it still argued that the unamortized portion be included in rate base.

The Administrative Law Judge concludes that \$24,000 is a prudent and reasonable expense and that it should be included in this rate case. The company's position that it should all be expensed in one year is rejected. Staff's approach to amortize the rate case expense over 3 years is accepted.

As discussed earlier in the attorney fees section, the company position is that the unamortized portion of these costs represent an investment by the owners and that it should be included in rate base. Staff's position that this would be part of working capital is also noted. Consistent with the result reached with Adjustment RA-2, the unamortized portion of the rate case expense, net of tax, is to be included in rate base.

13. Unanticipated Expense, P-9

The company proposed this adjustment to include in test period expenses an additional \$5,000 for unanticipated expenses, such as emergency repairs and maintenance costs. Commission staff contested this as an improper pro forma adjustment. The Administrative Law Judge agrees with staff; these expenses do not meet the test of being known and measurable, not offset by other factors. It is also noted that some of these expenses cited by the company, may be capital expenditures. This company Adjustment P-9 is not proper and is rejected.

14. Pro Forma Debt, PA-8

This Commission staff adjustment reflects the increased federal income tax expense calculated using staff's pro forma net average rate base and the weighted cost of debt described by staff witness Fred Ottavelli. This is a standard adjustment in general rate hearings and staff's suggested approach is accepted. It is recalculated, as set out below.



D. Results of Operations Summary

Having examined and made findings on the above results of operations adjustments, the Administrative Law Judge summarizes the accepted adjustments in the following table. Table II sets forth the results of operations found proper in this order. The Net Operating Income (NOI) of the company during the test period, as adjusted, is \$5,533.

TABLE II

ALDERTON-MCMILLAN WATER SUPPLY, INC.  
Results of Operations Summary  
12 Months Ended June 30, 1991

| Adjustment-Description           | <u>AMOUNT</u>  |
|----------------------------------|----------------|
| Net Operating Income-Actual      | \$38,279       |
| RA-1 Contractual Services        | 10,366         |
| RA-2 Capitalized Attorney Fee    | (6,027)        |
| R-2 Prior Year Rate Case Expense | (446)          |
| RA-3 Misc. Tax Adjustment        | 858            |
| RA-4 Salaries                    | (11,490)       |
| RA-5 Insurance Expense           | 1,104          |
| RA-6 Federal Income Tax          | (903)          |
| RA-7 Accounting Fees             | 0              |
| RA-8 Other Water Revenue         | 3,018          |
| RA-9 Restate Testing             | 1,249          |
| RA-10 Telephone Service          | 2,155          |
| RA-11 Restate Ratebase           | 1,200          |
| RA-12 Revenue Imputation         | 863            |
| RA-13 6446 Filing Expense        | (1,163)        |
| PA-1 Salaries and Fringes        | (24,995)       |
| P-3 Health Insurance             | 0              |
| P-2 New Truck                    | (3,496)        |
| PA-2 Management Fees View Royal  | 6,817          |
| PA-3 Purchased Water             | (2,740)        |
| PA-4 Underground locate Service  | (354)          |
| PA-5 Property Taxes              | (728)          |
| P-5 Retirement Plan - IRA        | 0              |
| PA-6 Rate Case Expense           | (6,800)        |
| PA-7 Water Mains                 | (406)          |
| P-9 Unanticipated Expense        | 0              |
| P-10 Water Tank                  | 0              |
| PA-8 Pro Forma Debt              | <u>(828)</u>   |
| Total Adjustments                | (\$32,746)     |
| Pro Forma Net Operating Income   | <u>\$5,533</u> |

RATE BASE

A. Legal Principles

RCW 80.04.250 provides, in part, as follows:

The commission shall have power upon complaint or upon its own motion to ascertain and determine the fair value for rate making purposes of the property of any public service company used and useful for service in this state . . . .

The company's per-books rate base is \$612,068. The parties have proposed various restating and pro forma adjustments. The company made such proposals through James Bacon, who presented the company's results of operations, Exhibit No. 10. Commission staff witness Julia Parker made an accounting examination of the company's results of operations, which is set forth in her Results of Operations Summary, Exhibit No. 31. Public counsel did not do an accounting review of the company's finances. In its brief, Public counsel recommended that the Commission adopt the restating and pro forma adjustments proposed by Commission staff in Exhibit No. 31.

Table III below shows a comparison of the presentations of the company and Commission staff regarding rate base items. Some of these figures have been updated to reflect changes made at hearing and/or on brief.

TABLE III

ALDERTON-MCMILLAN WATER SUPPLY, INC.  
Rate Base  
Comparison of Parties' Positions  
12 Months Ended June 30, 1991

| Adjustment-Description           | <u>Company</u>   | <u>Staff</u>       |
|----------------------------------|------------------|--------------------|
| Rate Base-Actual                 | <u>\$612,068</u> | <u>\$612,068</u>   |
| RA-2 Capitalized Attorney Fee    | 13,596           | 0                  |
| R-2 Prior Year Rate Case Expense | 1,050            | 0                  |
| RA-4 Salaries                    | 0                | 2,918              |
| RA-11 Affiliated interest        | 0                | (40,981)           |
| " Acquisition Adjustment         | 0                | (9,221)            |
| " Deferred FIT                   | 0                | (48,034)           |
| " Customer Advances              | 0                | (29,096)           |
| " Other Restating Rate Base      | 0                | (28,261)           |
| PA-1 Salaries and Fringes        | 0                | 3,977              |
| P-2 New Truck                    | 0                | 0                  |
| PA-6 Rate Case Expense           | 0                | 0                  |
| PA-7 Water Mains                 | 35,490           | 8,966              |
| P-10 Water Tank                  | <u>17,767</u>    | <u>0</u>           |
| Total Adjustments                | <u>\$67,903</u>  | <u>(\$139,732)</u> |
| Pro Forma Rate Base              | <u>\$679,971</u> | <u>\$472,336</u>   |

B. Adjustments

Most of these adjustments and their rate base treatment have already been discussed in the Results of Operations section. Please refer to Section IV above. However, the following adjustments will be discussed below: Restate Ratebase, RA-11; Water Tank, P-10; and Water Mains, PA-7.

1. Restate Ratebase, RA-11

In this proposed adjustment, Commission staff restated depreciation expenses and the plant account balances to the level it calculated to be included in rate base. Specifically, staff has: a) removed the profit and taxes portion of plant installed by an affiliated company (Ridgway Construction), b) made an acquisition adjustment on the purchase of the Alderwood Estates system, c) included the company's accumulated deferred income tax

in the rate base calculation, d) recognized the customer advance received from Pasquire Panel as a reduction from rate base, and e) according to Exhibit No. 56, the breakdown of Adjustment RA-11, removed an additional \$28,261 from rate base under the category of "other". These will be discussed below.

a) Affiliated Interest: Mr. Ridgway and his wife own Alderton-McMillin, as well as Ridgway Construction, Inc., a construction company Mr. Ridgway formed several years ago. Ridgway Construction is not in the business of performing construction work for others; in fact, Ridgway Construction does not own any equipment. After forming the company, Mr. Ridgway used Ridgway Construction to perform work for Alderton-McMillin. One such job involved the looping of a portion of El Dorado Estates. Mr. Ridgway obtained bids from contractors, then performed the work with leased equipment under Ridgway Construction. Although Mr. Ridgway's construction company did the work for less than the lowest bid, it still included profit for Ridgway Construction, as well as B&O and federal income taxes. Staff argued that only prudent capital expenditures for this looping project should be placed in rate base. Staff's adjustment excludes profit derived by Ridgway Construction, B&O and federal income tax associated with the construction. The company argued that staff would not have made this adjustment if the project had been done by the next low bidder; it thus contests this adjustment as being "unfair". The other looping project was Winchester Heights.

There is good reason to look closely at affiliated interest transactions. A review of the facts shows that the company formed its own construction company to perform construction projects for the company. Under the company's approach, the company would set the amount to be paid by ratepayers; this amount is to include profit, B&O and federal income taxes. The Administrative Law Judge is of the view that the company should attempt to provide service to its customers at the lowest possible cost. Alderton-McMillin could have leased the same equipment and performed the same work as that performed by Ridgway Construction. This was not the type of project that had to be done by outside contractors. The company clearly demonstrated this by the way it handled the project. Creating a separate company to perform the work and adding in profit to be paid by ratepayers when the company could have just as easily done the job is not appropriate. Under the circumstances, the prudent option was for the company to have performed the work. This is recognized by staff's treatment and the Administrative Law Judge adopts the approach taken by Commission staff. The other looping project, Winchester Heights, will be discussed later in Adjustment PA-7.

b) Acquisition Adjustment: During the period of 1982 through 1987, the company expanded considerably. It acquired a number of water systems, including Alderwood Estates. In or about August,

1987, Mr. Ridgway purchased the stock of Alderwood Estates for \$55,000, which was below the net book value of \$72,000. He later merged Alderwood Estates into Alderton-McMillin Water Supply, Inc. The company used the net book value of Alderwood Estates for rate base purposes. In staff's proposed adjustment, the rate base is reduced to equal the amount of stockholder investment, \$55,000; staff argued that there was no evidence of benefit to ratepayers by the sale and merger and that the ratepayers should not have to support a rate base beyond that reflected by the purchase price.

The company contested staff's approach. The company pointed out that the net book value of Alderwood Estates did not change by virtue of the sale and, further, that rate base was not removed from service or in any way diminished by the sale. The company argued that the Commission does not regulate the shareholder or the stock, but that it regulates the rate of return that a regulated company receives on its net book value. It argued that the ratepayers continued receiving full benefit of the plant in service and that the company should receive a return on its plant.

The company is not asking ratepayers to support an Alderwood Estates rate base amount beyond its net book value. The company went out on the open market and purchased the stock of Alderwood Estates. There was no evidence that this was other than an arm's-length transaction. The company happened to buy the stock for less than net book value, rather than more. The question could be asked whether an adjustment would be proposed to increase rate base in the event the company paid more than book value. Under the facts presented, the Administrative Law Judge is not persuaded that it is appropriate to adjust the rate base to reflect the purchase price. The net book value should be used for rate making purposes. Staff's proposed acquisition adjustment is rejected.

c) Deferred Federal Income Tax: Commission staff's proposed adjustment reduces rate base due to the company's accumulated deferred federal income taxes. Although the company questioned this adjustment, it did not rebut it or argue it on brief. The Administrative Law Judge notes that the tax laws require a deferral of taxes. Further, the Commission has consistently upheld such adjustments since the time mandatory deferred tax treatment was required. This adjustment is accepted.

d) Customer Advances: Pasquire Panel, a customer of the company, advanced money to the company to install pipe, build a storage tank and appurtenances to meet its needs. The company returns or pays back the money over a period of time and does not pay interest on the money advanced. Commission staff recognized this as a customer advance and proposed an adjustment to reduce rate base by the outstanding balance owed. The company characterizes the Pasquire advance as a loan and argued that the balance owed should be

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included in rate base. It argued that it would have been included in rate base had the company gone to a bank to finance the construction.

The approach taken by Commission staff more closely reflects appropriate regulatory treatment of this type of arrangement. As acknowledged by the company, this is not a loan from a bank involving interest charges. Pasquire Panel advanced money so the tank could be built and the company then paid back the principal amount, without interest, over time. The Administrative Law Judge agrees with staff that this should be treated as a customer advance for construction and, thus, the amount outstanding should be deducted from rate base. Staff's approach rightfully flows the benefits of this arrangement to the ratepayers. Staff's adjustment is accepted.

e) Other: As part of its Adjustment RA-11, Commission staff proposed an additional \$28,261 deduction from rate base under the category of "other". This portion of the adjustment was not explained or supported by evidence. Accordingly, the Administrative Law Judge concludes that this "other" component of Adjustment RA-11 is rejected.

## 2. Water Tank, P-10

According to Mr. Bacon's direct testimony offered on February 18, 1992, Exhibit T-8, at page 12, this company adjustment of \$10,000 is for the company's installation of "an additional storage tank which should be completed in the next day or two." Although Mr. Ridgway later expressed some confusion about which one of two tanks Mr. Bacon was referring to in his testimony, the Administrative Law Judge chooses to let stand Mr. Bacon's description of the tanks in Exhibit T-8. It is noted that the dollar amounts for each of the tanks are about the same. This "additional" P-10 tank had still not been placed into service as of the company's rebuttal testimony on May 26, 1992. Commission staff took the position that this tank be excluded from rate base since it is not currently serving customers. Should the tank later be placed into service, staff witness Julia Parker outlined staff's position on how it could be treated for ratemaking purposes.

The position of Commission staff should be adopted. This tank is not used and useful in providing service to the ratepayers and the cost should not be included in rate base. The company's proposed Adjustment P-10 is rejected. The other tank is discussed in Water Mains, PA-7, the section immediately following.

## 3. Water Mains, PA-7

This section corresponds to the company's proposed Adjustment P-11. Mr. Bacon explained that this adjustment is for

the capitalized costs of putting in the main looping of the Winchester system and reconnecting a storage tank to the system. In 1990, the company experienced a contamination problem that resulted in the company disconnecting a spring source of water, together with a storage tank. In this adjustment, the company proposed to include in rate base \$10,059 for reconnecting the storage tank and \$27,904 for the Winchester looping. Mr. Ridgway did the looping as Ridgway Construction, as previously discussed in the affiliated interest portion of Adjustment RA-11.

Commission staff agrees that these items are complete and in service, are known and measurable and that they should be included in rate base, but it disagrees on the amount of the adjustment. Staff witness Julia Parker documented the cost of reconnecting the tank to be \$8,632. As indicated above, Ridgway Construction performed the Winchester looping. Consistent with its approach in the affiliated interest portion of Adjustment RA-11, staff's adjustment excludes the amounts relating to profit and taxes; staff's adjustment proposed to include \$9,501 as the actual cost of materials and labor in installing the Winchester looping.

Commission staff's approach in Adjustment PA-7 is adopted, except for its rate base treatment, as discussed below. The reasoning for accepting this approach is discussed earlier in Adjustment RA-11 (affiliated interest portion). Staff's amounts of \$8,632 for reconnecting the tank and \$9,501 for the Winchester looping are accepted. However, staff's treatment of these amounts is not adopted. In its rate base adjustment, Staff used a method which limited the level of rate base inclusion and depreciation expense to an amount covering only half of the test period. Staff defined "pro forma adjustments" as follows:

Pro forma adjustments are ratemaking adjustments which give effect in a test period to all known factors which can be reasonably measured as though such factors had been in effect for the entire test period and to the extent they are not offset by other factors.  
[Julia Parker testimony-Exhibit T-30, p. 4]

Staff's rate base treatment in Adjustment PA-7 does not give effect to the rate base additions as if they were in effect for the entire test period. Staff has not indicated that any offsetting effects should be considered. The Administrative Law Judge concludes that it is appropriate to include these adjustments, net of tax, for the entire year, both for rate base and depreciation purposes. The pro forma rate base adjustment is calculated at \$17,894 and the adjustment to net operating income is a decrease of \$406.

C. Rate Base Summary

Table IV below contains a summary of the Administrative Law Judge's proposed findings regarding test period rate base. The total adjusted rate base is \$544,717.

TABLE IV

ALDERTON-MCMILLAN WATER SUPPLY, INC.  
Rate Base Summary  
12 Months Ended June 30, 1991

| Adjustment-Description           | Amount              |
|----------------------------------|---------------------|
| Rate Base-Actual                 | <u>\$612,068</u>    |
| RA-2 Capitalized Attorney Fee    | 12,055              |
| R-2 Prior Year Rate Case Expense | 893                 |
| RA-4 Salaries                    | 2,918               |
| RA-11 Affiliated interest        | (40,981)            |
| " Acquisition Adjustment         | 0                   |
| " Deferred FIT                   | (48,034)            |
| " Customer Advances              | (29,096)            |
| " Other Restating Rate Base      | 0                   |
| PA-1 Salaries and Fringes        | 0                   |
| P-2 New Truck                    | 0                   |
| PA-6 Rate Case Expense           | 17,000              |
| PA-7 Water Mains                 | 17,894              |
| P-10 Water Tank                  | <u>0</u>            |
| Total Adjustments                | ( <u>\$67,351</u> ) |
| Pro Forma Rate Base              | <u>\$544,717</u>    |

VI. RATE OF RETURNA. Legal Principles

A utility is entitled to the opportunity to earn a rate of return sufficient to maintain its financial integrity, attract capital on reasonable terms, and receive a return comparable to other enterprises of corresponding risk. Bluefield Water Works Improvement Co. vs. PSC of West Virginia, 262 U.S. 679 (1923) and FPC vs. Hope Natural Gas Co., 320 U.S. 591 (1944).



## B. Positions of the Parties

The company proposed a 13 percent overall rate of return. No detail was provided by the company as to the derivation of this figure, except Mr. Bacon's explanation that Commission staff has been recommending between 12 percent and 13 percent for water companies. He added that most of the company's debt is at 12 percent.

The Commission staff rate of return proposal was presented through Fred Ottavelli. Staff recommended 12.57 percent as an overall fair rate of return. In his determination, Mr. Ottavelli used a 13 percent return on equity and 11.09 percent cost of debt. Mr. Ottavelli used a capital structure of 77.60 percent equity and 22.40 percent debt.

Public counsel witness Kevin Winters testified that the company should receive a zero percent return on its equity based on the company's poor service to its customers. Mr. Winters recommended an overall rate of return of 3.87 percent (0 % on equity and 3.87% on debt). He calculated this return on a capital structure of 65.53 percent equity and 34.47 percent debt.

## C. Rate of Return Summary

The overall rates of return proposed by the company and Commission staff are pretty close (13% and 12.57% respectively). The Administrative Law Judge adopts the capital structure, weighted cost rates and fair rate of return proposed by Commission staff. Commission staff's figures are best supported on the record and will result in an appropriate revenue requirement for the company.

Public counsel's rate of return recommendations are specifically rejected. The company is entitled to the opportunity to earn a fair rate of return on its investment.

Table V below reflects the capital structure and cost rates and fair rate of return accepted as reasonable for purposes of this rate case. Based upon the findings in this order, the respondent's overall authorized rate of return is 12.57 percent, as set out below.

TABLE V

ALDERTON-MCMILLIN WATER SUPPLY, INC.  
Rate of Return Summary

| <u>Capital<br/>Structure</u> | <u>Weight%</u> | <u>Cost Rate%</u> | <u>Weighted<br/>Cost%</u> |
|------------------------------|----------------|-------------------|---------------------------|
| Debt                         | 22.40          | 11.09             | 2.48                      |
| Equity                       | <u>77.60</u>   | 13.00             | <u>10.09</u>              |
| Total                        | <u>100.00%</u> |                   | <u>12.57%</u>             |

VII. GROSS REVENUE DEFICIENCY

Table VI details the calculation of the gross revenue deficiency of \$79,690.

TABLE VI

ALDERTON-MCMILLAN WATER SUPPLY, INC.  
Revenue Requirement Calculation

|                                 |                 |
|---------------------------------|-----------------|
| Pro Forma Rate Base             | \$544,717       |
| Authorized Rate of Return       | <u>12.57%</u>   |
| Required Net Operating Income   | \$68,471        |
| Pro Forma Net Operating Income  | <u>\$5,533</u>  |
| Net Operating Income Deficiency | \$62,938        |
| Conversion Factor               | <u>0.789781</u> |
| Revenue Requirement             | <u>\$79,690</u> |

VIII. RATE SPREAD

The company proposed that the entire revenue increase be assigned to the basic charges in each tariff on a uniform basis.

It did not propose to apply any of the increase to the usage portion.

The Commission staff presented rate spread testimony by Ellie Reynolds. Ms. Reynolds recommended that half of the revenue requirement be placed on the usage rate and the other half be collected in a basic charge increase. Ms. Reynolds noted that as the usage rate is increased, the customers will be encouraged to use water wisely. She added that a higher usage rate would also give the company a greater incentive to read its meters.

In order to determine that usage would generate half of the revenue requirement, Ms. Reynolds developed a random sample study to determine the average water usage. She used a 10 percent sample of customers. Her study resulted in an average monthly consumption is 1,082 cubic feet per customer. She then spread the rates by placing half of the requirement on the basic charges on all 1,310 customers and increasing the usage charge to generate the remaining revenue.

Public counsel presented its rate design proposals through Kevin Winters. Public counsel recommended that any rate increase be collected only through water usage blocks, not through any additional charge to the basic charge. Mr. Winters argued that placing the revenue increase on metered usage will provide significant incentives for the company to improve its water service and quality. It was further argued that the company's basic charge is already too high. Public counsel supported the use of Commission staff's consumption study.

Public counsel recommended that the revenue increase granted by the Commission have a one-year sunset date. In his testimony, Exhibit No. T-40, at pages 23 through 25, Mr. Winters proposed a number of minimum service standards and procedures. Many of these recommendations are similar to those offered by Commission staff witnesses; others are discussed elsewhere in this order. Mr. Winters recommended that the Commission grant a revenue increase contingent upon the company meeting these conditions. He suggested that renewal of the rate tariffs should be contingent upon the company demonstrating after one year that it has met the Commission-ordered service standards.

On rebuttal, the company took exception to Commission staff's proposed average monthly consumption figure and alleged that such figure caused staff to overstate projected revenues. Dennis Ridgway performed a water consumption study and came up with a monthly water consumption figure of 931 cubic feet per customer. He also referred to a City of Puyallup study which contained slightly higher figures than his study. In his study, Mr. Ridgway acknowledged that he did not adjust actual usage to billed usage; the effect of this flaw reduces his average monthly consumption

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figure. Also, Mr. Ridgway used different periods of time in his study; the effect of this inconsistency was also shown to result in a lower usage figure. The record further shows that Mr. Ridgway used some incorrect consumption figures in his study, the result of which contributed to his lower consumption number.

While not satisfied with Mr. Ridgway's study, the Administrative Law Judge is likewise not convinced of the reliability of the figures produced in staff's study. As an example, the totals of bimonthly billings indicate that the January/February period is the second highest bimonthly period of the year, when testimony has indicated that winter months have lower usage than summer months. This total January/February consumption is substantially impacted by customer No. 472 whose bimonthly consumption for this period was 47,600 cubic feet; this represents 66 percent of this customer's total usage for the year. Removal of this single customer from Ms. Reynolds' sample would reduce the average consumption for the remaining customers by approximately 46 cubic feet per month. While Ms. Reynolds took a substantial sample of the customers, her study does not indicate the confidence to be placed in the representiveness of this sample, i.e., the probable error of the mean and other statistical measures. A review of her sample shows substantial individual variances from the mean.

The Administrative Law Judge thus proposes that the revenue requirement be collected by imposing a flat percentage increase to all revenue rates. This will impact the usage rate, as well as the monthly charges. The Administrative Law Judge agrees with staff's expressed goals in spreading the rates, but feels a measurement of the impact of staff's proposed rates is uncertain at best. A flat percentage increase will best meet the concerns of the parties. An appropriate message will be sent to the ratepayers and the company would be certain of collecting the approved revenue increase.

The Administrative Law Judge accepts staff's position that the \$15.00 disconnect visit service charge adopted in this order will produce revenues of \$1,800 per year. The flat percentage is to be calculated after subtracting \$1,800 from the total revenue requirement approved in this order. So, after subtracting the disconnect visit service charge revenue, the revenue requirement for general rates is \$77,890. Using \$249,874 (Exhibit 31) as the pro forma revenue amount, the percentage increase required is 31.17%.

Public counsel's proposal that the approved rate increase have a one year sunset date is rejected. Public counsel's concerns are well taken, but have been addressed by other provisions of this order; adequate safeguards are in place.

### IX. PUBLIC PARTICIPATION

A hearing was held on April 16, 1992, in McMillin, for the purpose of taking testimony from members of the public. Several hundred people attended the hearing. Thirty nine members of the public testified. Their testimony covered both the request for a general rate increase and the request for interim rates. The testimony was clear: the ratepayers of Alderton-McMillin overwhelmingly opposed the company's request for a rate increase. Also, the SAM (Subscribers of Alderton-McMillin) Association also opposed the company's request.

The ratepayers on the various Alderton-McMillin systems, opposed the company's request for a myriad of reasons. The ratepayers were angry and upset about the deplorable quality of the water and poor service they are presently getting. They feel their rates are high enough now and are against paying more to a company operated by someone in whom they have lost faith, trust and confidence. The customers have experienced problems for years. Their testimony demonstrated that the water quality problems and water service problems continue.

The complaints of the customers were numerous and varied. Many brought in water samples showing significant discoloration and impurity. There were complaints of iron and other elements in the water. Residents complained of the water's offensive taste and smell. Some residents testified that they believe the poor quality of water caused health problems for them and their children. Many customers have installed water filters, which become clogged due to the impurities. Some customers refuse to drink the water. Many customers in the various Alderton-McMillin systems have resorted to the trouble and added expense of buying bottled water to drink. There were complaints of itching and breaking out when using the water for bathing. Ratepayers have been forced on repeated occasions to go without water for extended periods of time. Customers have experienced these numerous water outages, and shut-offs for repairs, without notice from the company. Customers have had to do without working toilets, showers and other modern conveniences. The customers complained about damage to their appliances allegedly caused by the water. There were many complaints about stains on clothes and fixtures. There are water pressure problems, as well as fire flow problems, on the various systems. Property owners in Chinook Estates are unable to build on their lots because a moratorium on building permits has been imposed due to the water-related problems. There were also numerous complaints about high hook-up fees charged by Mr. Ridgway.

The ratepayers have lost confidence and faith in the company and its owner, Dennis Ridgway. Customers complained about Mr. Ridgway's questionable and imprudent use of company funds. Mr. Ridgway has failed to keep his promises to customers in the past.

Customers have repeatedly been unable to contact Mr. Ridgway concerning the problems they are experiencing. The complaint was made that the company does not keep adequate office hours. Mr. Ridgway has failed to respond or return calls to customers. Based on their past experiences, many customers don't trust Mr. Ridgway.

In addition to the public testimony, written comments from ratepayers were included in the record as an illustrative exhibit. The problems and concerns are similar to those summarized above.

The ratepayers provided valuable input concerning the water quality, quantity and service problems they experience with Alderton-McMillin. This information is extremely useful. The ratepayers effectively demonstrated the seriousness of the situation.

#### X. WATER QUALITY AND SERVICE

Alderton-McMillin has provided poor water quality and service to its customers. The customers complained and wrote letters to the Commission about the problems. Commission staff investigated these matters. Teresa C. Osinski, WUTC Policy Research Specialist, reviewed the complaints and letters, as well as a consumer questionnaire. Ms. Osinski also conducted personal interviews with customers. The problems included fear of contaminants and bacteria in the water, pressure problems, interruption of service, non-responsiveness of the company, billing and disconnection errors and meter-related problems. These problems are ongoing.

##### A. Water Testing

In view of the major concern of water quality, Commission staff decided to have the water tested by an outside laboratory. Laucks Testing Laboratories, Inc. (Laucks), a certified laboratory, performed the tests. James M. Owens, President and Lab Director of Laucks, testified about the tests. The first samples were taken on February 12, 1992 primarily at well sites and distribution blow-offs throughout the various Alderton-McMillin systems. The sites were flushed at least three minutes before the samples were taken. The results of the bacteria tests showed the presence of coliform at an Alderwood Estates wellhead, a Pleasant Valley blow-off valve and a Chinook Valley meter box. Six of the samples were found to be "turbid", i.e., the presence of bacteria was indicated, but the presence or absence of coliform was masked by the rapid growth of other bacteria. Fecal coliform was not present in any of the tests.

Various inorganic tests were also taken; iron and manganese were the only inorganic analytes found to be in excess of

the Maximum Contaminate Level approved by the Department of Health. Three Volatile Organic Compound tests were taken and none of the samples exceeded EPA's maximum contaminate levels.

Follow-up tests were performed on the systems where coliform was found to be present. A total of six follow-up samples were taken on February 27, 1992 from kitchen faucets in houses on the Alderwood Estates, Pleasant Valley and Chinook Estates systems. Again, the water was allowed to flow at least three minutes before the samples were taken. A flame was applied to the faucets for sterilization. On the Alderwood Estates system, the follow-up tests indicated the presence of coliform in one home and the other sample result was turbid. Both homes on the Pleasant Valley system tested positive for coliform. The two homes tested on the Chinook Estates system tested negative for coliform. Following the tests, the Commission staff turned the test results over to the Department of Health and the company.

On rebuttal, the company presented testimony from Michael Heath, a Public Health Advisor with the Department of Health. Mr. Heath admitted that he was not an expert in water sample collection and that he "didn't know a whole lot" about the use of blow-off valves as sampling sites for coliform. Mr. Heath agreed with Mr. Owens of Laucks Labs that water samples can be collected anywhere in the distribution system, as long as the collection site is representative of the water in the system per WAC 246-290-300. He could not say that the water samples taken from blow-off valves by Laucks Labs in this case were not representative samples. He did not know what would be representative sites in the Alderton-McMillin systems. In his rebuttal testimony, Mr. Ridgway objected to the samples being taken at blow-offs.

Mr. Heath acknowledged that there are a number of Department-approved methods for water sampling. The chief method of disinfecting, and the only method required by the Washington Administrative Code (WAC), is to flush the line. He added that removal of the aerator from the spigot is advisable and further, that some sample collectors use a chlorine solution before taking a sample; he acknowledged that these practices were not required by the WAC.

As a result of the tests performed by Laucks, the company and a Department of Health representative took some water samples. Two systems tested clear. Two of the tests from the Pleasant Valley system tested positive and the company sent out "boil water" notices. The company then chlorinated the tank and replaced a seal. The company's follow-up tests came back with satisfactory results.

This record amply demonstrated that the company has had water quality problems. The testing has borne this out. The

company has the responsibility to remedy the problems and provide safe, adequate and efficient service. The Commission will need to monitor the company's progress. The testing of the water will continue.

Customers have expressed distrust in the company's sampling procedures. In response, Commission staff witness Teresa Osinski recommended that the company coordinate with the Department of Health (DOH) in developing a schedule for water sampling throughout the systems wherein an attempt would be made to have a DOH representative present during at least 3 sampling processes over the first 6 months from the date of the Commission's final order. Commission staff recommended that the company, or the lab that performs the testing, submit all results for all tests for a period of 6 months from the date of the Commission's final order.

#### B. Operations Maintenance

Based on her review of the complaints against the company, Ms. Osinski questioned whether the company was complying with WAC 480-110-076, which requires the company to maintain its plant and system in a manner that will enable it to furnish adequate service. Commission staff thus recommended that the company develop a 12 month maintenance plan for each of its water systems that will satisfy the requirements of DOH and the Commission. Ms. Osinski suggested that this plan be completed and submitted to the Commission within 60 days of the Commission's final order. Public counsel supports this recommendation.

In accordance with WAC 480-110-041, Ms. Osinski recommended that a copy of the required guide be kept in a notebook containing: 1) all water company-related WACs, 2) the Final Commission Order in this case; 3) the company's currently adopted tariff; 4) the annual schedule of maintenance, by system, as submitted to the Commission; and 5) written descriptions of the company's policy on procedures to respond to reported emergencies or service failures. She suggested that the notebook be clearly marked and be readily available for customers to review in the office. The guide has been prepared by the Commission and is available to the company at no charge. Public counsel supported this recommendation.

The company has kept very poor records. This has caused considerable problems and has added to the time needed to be spent on this investigation. In order to reduce the time necessary for audits in the future, staff witness Julia Parker recommended that the company be directed to set up a record keeping system acceptable to staff. Staff will presumably work with the company in setting up this record keeping system.



Public counsel witness Winters recommended that the Company hold quarterly meetings with SAM or other customer groups until the company's next general rate case. Mr. Winters also suggested that the company give the Commission advance notice of any sale or divestiture of any portion of the Alderton-McMillin system.

C. Water Quality and Service Matters

Concerning the problems with water pressure on the various systems, Ms. Osinski noted that much of the problem lies in the infrastructure. In her opinion, long term solutions will have to wait until a Comprehensive Water Plan is completed. In the short term, she recommended that the company prepare a notice to be sent to the customers on each system known to have had problems with pressure (particularly during the summer months) which addresses steps they can take to alleviate the water pressure problems in their systems. She suggested that the notice address ideas of alternative schedules for water use. Commission staff further recommended that the company monitor water pressure in those water systems with water pressure problems, especially in the Alderton-McMillin corridor and Chinook Estates systems. If water pressure in any system is dropping below the legal pressure requirements, the company must take steps to advise residents of the alternative water use practices. The company is to check whether the pressure reduction is due to mechanical breakdown.

Public counsel recommended that the company be ordered to devise a water conservation plan within one year of the date of the Commission order. It suggested that the plan include a description of the cost-effect water-saving measures that can be implemented, a method of financing the measures and a method of getting them implemented in customers' homes. Public counsel offered to assist the company in the preparation of such a plan and suggested that the Department of Health might also be helpful.

Customers in the Alderton-McMillin systems experience frequent, unscheduled shut-offs of service. In addition to her recommendation that the company develop a detailed maintenance schedule as discussed earlier, Ms. Osinski recommended that the company conform with WAC 480-110-076 and give customers 24 hours notice of scheduled interruptions. Also, this WAC requires the company to keep a record of all interruptions if a substantial number of customers are affected. This record is to include the location, date and time, duration and, if possible, the cause. Ms. Osinski suggested that the company include the exact number of customers affected and the steps taken to keep a repeat outage from occurring. In complying with the 24 hour notice requirement, Ms. Osinski recommended that the notices be sent by U.S. Mail and not hand delivered as mail box inserts due to the usage of post office boxes in these areas. She further recommended that the company

develop a way to inform customers of emergency shut-offs through use of the various customer associations, as discussed on pages 12 and 13 of her testimony, Exhibit No. T-25.

Many customers were dissatisfied with the customer service of the company. As a first step toward alleviating this problem, Ms. Osinski recommended that the company comply with the requirements of WAC 480-110-096, which includes keeping a record of any complaint or dispute involving the company and a customer. She recommended that the company also include in this record, entries for all calls received, including the actions taken to respond to the caller's request. Ms. Osinski suggested that these entries include: the caller's name and address, date and time of call; reason for the call, action taken the company in regard to the call, and the date and time of all call backs. Commission staff recommended that this customer complaint/dispute record be submitted to the Commission within 3 months of the Commission's final order, then quarterly until formally notified that such submittals are no longer necessary.

To assist Commission staff in reviewing the complaint/dispute record and verifying the company's responsiveness, Ms. Osinski recommended that the company prepare a written policy addressing the idea of prioritizing requests. Commission staff expects the company to return each call received by the end of the next working day, unless the customer states that no return call is necessary. This policy on how the company will respond to calls is also to include emergency response procedures, as required by WAC 480-110-041. Public counsel suggested that the company respond to emergencies immediately.

In response to complaints from customers that the company is not accessible, Ms. Osinski recommended that the Commission order Alderton-McMillin to establish, at a minimum, official office hours on Tuesdays and Thursdays from 9:00 a.m. to 1:00 p.m. She further suggested that the company post its office hours for the public to see. The company has agreed to open an office on a part-time basis. Public counsel went further and recommended that the company keep regular office hours 8 hours per day, Monday through Friday, or open at least twenty hours per week; the Administrative Law Judge does not feel these longer hours are needed at present. Ms. Osinski's recommended hours per week should be adopted. These hours should be increased in the future as customer need requires.

In an attempt to further improve the company's service to its customers, Commission staff recommended that the company purchase a voice mail box type service instead of the answering service it has used. On rebuttal, the company agreed to this recommendation.

#### D. Meters

The record is replete with meter-related problems. The company has kept poor meter reading records. Commission staff recommended that the company comply with the meter history records requirements of WAC 480-110-166. Some customers' meters were broken and/or otherwise not capable of being read. The company has resorted to estimating water usage of some of its customers. Commission staff recommended that the company read meters on a regular basis and only estimate readings in extreme circumstances. In such instances, staff suggested that the company bill the customer only the basic charge; total consumption would then be billed in the next billing cycle. This would prevent "overestimating" and could be an incentive for the company to read meters. Noting the importance of production meters, Ms. Reynolds recommended that production meters be read at the same time the company reads customers' meters.

The company has converted customers to flat rates for various reasons. The company has a number of flat rated customers on its systems. The company reports 116 flat rated customers, but the exact number was not determined. Commission staff witness Ellie Reynolds recounted the problems caused by the company's flat rate situation. She recommended that the company install meters for all customers where economically feasible. The company would be expected to supply data supporting any claim that a meter would not be economically feasible in a given case. Recognizing that it is unrealistic to order the company to immediately meter all customers, Ms. Reynolds recommended that the company file a plan with the Commission setting forth its schedule for metering customers. She suggested that all customers have meters installed by March 1, 1993. In the future, after the current problems are remedied, she suggested that broken be replaced within one week of being identified.

Public counsel made similar suggestions regarding meters. Mr. Winters suggested that all customers should have operating meters within one year from the date of the Commission's order and be served under Schedule No. 2, the company's metered rate tariff.

#### E. Possible Receivership

As mentioned earlier, the Commission, in its complaint and order suspending, alleged violations under RCW 80.28.030 and RCW 80.28.040 relating to the purity, quality, volume, and pressure of water supplied by the company to its customers, as well as relating to the rules, regulations, measurements, practices, acts, and services of the company. Water companies are required to comply with state board of health standards adopted under RCW 43.20.050(2)(a) and department standards adopted under chapter 70.116 RCW. Failure of a water company to timely comply with

Commission-ordered water or service improvements can ultimately result in the company being placed in receivership. RCW 80.28.030 and RCW 80.28.040.

Commission staff witness Fred Ottavelli discussed the possibility of the Commission requesting the Department of Health to petition the court to place the company in receivership in the event the company fails to comply with the Commission order. Public counsel argued that the evidence of poor water quality and service in this case justifies beginning the process of placing the company in receivership. It suggested that the Commission establish the service standards and a deadline by which the company must meet the standards. It requested that a hearing be scheduled one year from the date of the Commission final order to assess company compliance. If the company is found to have failed to comply with this Commission order, Public counsel suggested that the Commission should then request the Department of Health place Alderton-McMillin in receivership.

The Administrative Law Judge rejects the suggestion that a "compliance" hearing automatically be held one year from the date of the final Commission order. At the same time, it is pointed out that the company's compliance with the Commission-ordered standards will be monitored by Commission staff on an ongoing basis. It is not necessary or appropriate to take additional action on possible receivership at this time. The company has adequately been put upon notice as to its obligations under the law and this order.

## XI. OTHER TARIFF CHANGES

### A. Disconnect Visit Service Charge

The company described the situation encountered by it when a customer has failed to pay a bill and, following a notice of disconnect, the company has had to dispatch a representative to disconnect service due to nonpayment only to be given payment at the time of the disconnect visit. This occurred approximately 120 times during the test year. The company has had to go to the expense of sending notices and dispatching its representative to the customer's premises; its current tariff does not provide for the assessment of a service charge in this situation. The company proposes to assess a \$15.00 service charge to a customer under these circumstances. Commission staff supported this proposed tariff change, while Public counsel opposed it.

This disconnect visit service charge is found to be reasonable and should be approved. Should the concerns of Public counsel materialize, the Administrative Law Judge points out that there are adequate complaint procedures available to ratepayers.

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B. Taxes on CIAC for Service Connection Charges

The company further requested a tariff change to allow it to collect federal income tax on Contributions in Aid of Construction (CIAC) for service connection charges. Commission staff noted that this request is in compliance with past Commission orders and supports the request. This tariff change should be approved.

FINDINGS OF FACT

Having discussed in detail all material matters inquired into, and having stated findings and conclusions, the Administrative Law Judge now makes the following summary of those facts. Those portions of the preceding detailed findings pertaining to the ultimate findings are incorporated by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the State of Washington vested by statute with authority to regulate rates, rules, regulations, practices, accounts, securities, and transfers of public service companies, including water companies.

2. Respondent Alderton-McMillin Water System, Inc. is a public service company engaged in the business of furnishing water service to customers within the State of Washington, and, as such, is subject to regulation by the Washington Utilities and Transportation Commission.

3. On September 13, 1991, the company filed tariff revisions designed to effect general increases in its rates for water service in this state. The proposed rates are designed to produce increased gross annual revenues of approximately \$172,000. The Commission suspended the filing by order entered on October 31, 1991.

4. On January 21, 1992, the company filed a Petition for Interim Rate Relief in this docket in the annual amount of \$45,669. The Commission heard testimony of this interim request and on June 3, 1992, the Commission entered its First Supplemental Order denying interim rates.

5. The twelve-month period ending June 30, 1991 is the appropriate test period to examine for ratemaking purposes in this matter.

6. The respondent's adjusted rate base is properly valued at \$544,717.

7. The appropriate capital structure for ratemaking purposes is 22.4 percent debt and 77.6 percent equity.

8. An overall rate of return of 12.57 percent on respondent's adjusted rate base does not exceed a fair amount, which would allow respondent to maintain its credit and financial integrity and enable it to acquire sufficient new capital at reasonable terms to meet its service requirements.

9. The respondent's test year Net Operating Income within the State of Washington after all adjustments is \$5,533 under present rates.

10. A revenue deficiency exists in adjusted test period gross annual revenue on respondent's water operations in the amount of \$79,690 calculated on the rate of return found appropriate in this order.

11. The rate spread proposals recommended by the parties are rejected. As found appropriate in the body of this order, after deducting the \$1,800 disconnect visit service charge revenue, a flat rate percentage increase of 31.17 percent to all revenue rates will fairly apportion the burden of the additional rates among the customers of the company and will result in rates that are fair, just and reasonable.

12. The tariff revisions filed by the respondent on September 13, 1991, would produce increased annual revenues in excess of those found to be fair above.

13. The tariff revisions filed by the respondent on September 13, 1991, should be rejected in their entirety. The respondent should be authorized to file revisions which will produce additional revenues not to exceed \$79,690, as determined in the body of this order. The company's requested tariff change for collection of federal income tax on CIAC is approved. The tariff revisions shall conform with the terms of this order.

14. The tariff revisions authorized in this order will result in rates and charges that are fair, just and reasonable.

From the foregoing findings of fact, the Administrative Law Judge enters the following proposed conclusions of law.

#### CONCLUSIONS OF LAW

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

2. The respondent's existing rates and charges for water service in tariff WN U-2 are insufficient to yield reasonable compensation for water services rendered in the State of Washington. Revisions of rates and charges made in accordance with the above findings will yield a fair rate of return on the respondent's rate base found proper in this order, and, if filed as authorized, will be fair, just, reasonable and sufficient.

3. The tariff revisions under suspension in Docket No. UW-911041 contain rates and charges which exceed those found reasonable in this order. They should be rejected in their entirety.

4. The company has supplied poor water and provided inadequate service to its customers. The ratepayers aptly described these deplorable conditions at the public hearing. The company has neglected its obligations to the ratepayers. It has been unresponsive to its customers. There are serious concerns about this company and its management. The water testing done in this case served the purpose of confirming ratepayer complaints that there are in fact water quality problems with this company. Upon considering the multitude of problems, the recommendations as discussed earlier in this order should be adopted in order for this company to better serve its customers. As set out in Section X, these include recommendations on: schedule and reporting of water sampling; maintenance plan for each water system; WAC 480-110-041 notebook; new record keeping system; meetings with customer groups; advising Commission of system divestitures; water pressure notices and monitoring; preparing a water conservation plan; WAC 480-110-076 notice of interruptions and record to be kept; WAC 480-110-096 record of complaints/disputes, preparing policy for handling customer calls and submission of record to the Commission; minimum office hours of Ms. Osinski; voice mail box service; WAC 480-110-166 meter history records and regular reading of meters (customer and production); billing only basic charge on estimates; metering customers; and filing a plan on a schedule for metering customers (completion by March 1, 1993 may be too optimistic, but Public counsel's suggested period of one year from the date of the Commission order is accepted as a reasonable guideline).

5. As a public service company supplying water service in this State, the respondent must comply with State Board of Health standards adopted under RCW 43.20.050(2)(a) and Department of Health standards adopted under chapter 70.116 RCW. A failure of a water company to timely comply with Commission-ordered water or service improvements can ultimately result in the company being placed in receivership. RCW 80.28.030; RCW 80.28.040.

6. During the course of the hearings, there were various motions made, i.e., to dismiss, to incorporate evidence, to strike testimony and on the admission of exhibits. All motions

made in the course of these proceedings which are consistent with the above findings and conclusions should be granted, and those inconsistent should be denied.

7. The Commission should retain jurisdiction in this proceeding.

On the basis of the above analysis of the evidence, findings and conclusions, the Administrative Law Judge enters the following initial order.

O R D E R

IT IS ORDERED That:

1. The tariff revisions filed by Alderton-McMillin Water Supply, Inc. on September 13, 1991, now under suspension and docketed in Docket No. UW-911041 are hereby rejected in their entirety.

2. The respondent is authorized to file revisions to tariff WN U-2 in the form found to be appropriate in this order, to produce no more than the additional gross revenues above found to be proper for the respondent's provision of water services within the State of Washington.

3. The filings authorized in this order shall bear an effective date which will allow the Commission at least three working days following receipt to consider them. The filings shall reflect no retroactive rate treatment and each sheet shall bear the notation, "By authority of order of the Washington Utilities and Transportation Commission, Docket No. UW-911041".

4. Material in support of the manner in which the authorized increase is obtained shall be submitted simultaneously with the filings.

5. A notice of the filings authorized in this order shall be posted, on or before the day of filing with the Commission, at each business office of the respondent. The notices shall state when the filing is to become effective and shall advise that a copy of the filing is available for inspection at each business office. The notice shall remain posted until the Commission has acted on the filing.

6. The company is to comply with the recommendations found proper in this order. See Conclusion of Law No. 4.

7. All motions consistent with this order are granted and those inconsistent are denied.



8. The Commission retains jurisdiction to effectuate the provisions of this order.

DATED at Olympia, Washington and effective this 14th day of July, 1992.

OFFICE OF ADMINISTRATIVE HEARINGS

  
ELMER E. CAMPFIELD  
Administrative Law Judge

**NOTICE TO PARTIES:**

This is an initial order only. The action proposed in this order is not effective until a final order of the Utilities and Transportation Commission is entered. If you disagree with this initial order and want the Commission to consider your comments, you must take specific action within a time limit as outlined below.

Any party to this proceeding has twenty (20) days after the service date of this initial order to file a Petition for Administrative Review, under WAC 480-09-780(2). Requirements of a Petition are contained in WAC 480-09-780(4). As provided in WAC 480-09-780(5), any party may file an Answer to a Petition for Administrative Review within ten (10) days after service of the Petition. A Petition for Reopening may be filed by any party after the close of the record and before entry of a final order, under WAC 480-09-820(2). One copy of any Petition or Answer must be served on each party of record and each party's attorney or other authorized representative, with proof of service as required by WAC 480-09-120(2).

In accordance with WAC 480-09-100, all documents to be filed must be addressed to: Office of the Secretary, Washington Utilities and Transportation Commission, 1300 South Evergreen Park Drive S.W., P. O. Box 47250, Olympia, Washington, 98504-7250. After reviewing the Petitions for Administrative Review, Answers, briefs, and oral arguments, if any, the Commission will by final order affirm, reverse, or modify this initial order.