

Agenda Date: August 28, 2014
Item Number: A1

Docket: UW-110436
Company Name: Olympic Water and Sewer, Inc.

Staff: Jim Ward, Regulatory Analyst
John Cupp, Consumer Protection Staff

Recommendations

1. Dismiss the Complaint and Order Suspending the Tariff Revisions filed by Olympic Water and Sewer, Inc., in Docket UW-110436 dated April 10, 2014.
2. Allow the revised rates and tariff revisions filed by Olympic Water and Sewer, Inc., on August 22, 2014, to become effective September 1, 2014.
3. Issue an Order Allowing Deferral of Well No. 17 drilling and partial legal cost to be included in the replacement source of supply for the North Aquifer Well System.

Background

On March 7, 2014, Olympic Water and Sewer, Inc. (Olympic or company), filed a proposed general rate increase that would generate \$52,124 (7.8 percent) additional annual revenue. This general rate increase is in the form of a surcharge and is filed pursuant to UW-110436 Order No. 1 granting deferral of certain costs associated with drilling Well No. 17 and the investigation and remediation of contamination discovered while drilling that well in April 2009. Olympic serves 1,608 mixed use customers near Port Ludlow in Jefferson County. The company's last rate change was effective May 22, 2008.

On September 15, 2010, Olympic filed a tariff revision that would generate \$182,097 (25 percent) additional annual revenue to its tariff. Staff's subsequent review of Olympic's books, records and supporting documents showed a large portion of the proposed rate increase resulted from the \$32,794 construction costs and \$18,500 in legal costs related to drilling Well No. 17 and the investigation of soil contamination discovered while drilling Well No. 17. Well No. 17 was ultimately deemed unusable for production due to soil contamination discovered during the drilling process.

Because investigation and remediation of the contamination costs were unknown and on-going, staff removed those costs from the rate case. The result of these adjustments and other allocations showed that the company had not demonstrated its need for additional revenue. On March 9, 2011, the company requested, and staff concurred, that the commission dismiss the Complaint and Order Suspending the Tariff Revision in Docket UW-101543 filed by Olympic on September 15, 2010, and allow Olympic to withdraw the tariff revision. The withdrawal letter filed by the company was conditioned upon the commission approving the accounting petition. The withdrawal was allowed and the rates for water service remained unchanged.

On March 7, 2011, Olympic filed a petition in Docket UW-110436 requesting an accounting order authorizing deferred accounting treatment for costs associated with drilling Well No. 17, and the investigation and remediation of soil contamination discovered while drilling Well No. 17. Costs would include, but are not limited to, actual well drilling, consulting, engineering, legal fees, testing and other costs associated with the investigation and remediation of soil contamination discovered while drilling Well No. 17. Deferred accounting treatment would preserve Olympic's ability to seek recovery of those costs at a later time.

Staff concurred with the company's request for deferred accounting treatment. See Staff's open meeting memo of April 24, 2014, for all conditions. Under section 8 of the conditions, the company had options for filing for deferred cost.

- 8 a - The company may file tariff revisions to recover Well No. 17 drilling and soil contamination investigation costs when the costs are known and measurable and the responsibilities for costs have been finalized between any insurance provider or other third party.
- 8 b - The company may file tariff revisions to recover soil contamination remediation costs when the costs are known and measurable and the responsibilities for costs have been finalized between any insurance provider or other third party.

The company is seeking cost recovery under condition 8a in this filing.

Discussion

History of need for additional or replacement source for North Aquifer Well System (Attachment 1)

The company was aware of the risk that Well No. 2 may lose capacity or fail if the company continued to use it as the main source for the North Aquifer Well System. The company identified the following alternatives:

1. Continue to operate with then-current wells No. 2 and No. 3 knowing that the future capacity of Well No. 2 is unknown and Well No. 3 has issues with recovery capacity while at the same time, determine if drilling another well at the Well No. 2 site into the same aquifer would be possible.
2. Drill a replacement deep well at another location in the North Aquifer Well System.
3. Transport water from a known source from the South Aquifer Well System (mainly Well No. 5).

After these alternatives were identified, the company determined the cost and risk of each alternative.

Alternative 1 involved simply waiting until Well No. 2 failed to produce. The cost was determined to be minimal unless Well No. 2 failed to meet production capacity. Then, the cost

was likely to be high and immediate action would be needed to provide water supply and drilling a new well at the site of Well No. 2 would then be explored.

Alternative 2 would require that a new well be drilled which would involve land purchase, a water rights request to Department of Ecology (DOE) and the cost of well construction. Each item was prioritized in accordance with an assessment of its probable cost and risk. The company concluded that new property acquisition was too expensive and too risky and rejected that alternative.

Alternative 3 was reviewed and explored with projected costs of \$1,654,603, including estimated costs for known requirements, such as arsenic treatment and installation of additional booster pumping. If continued usage, larger replacement piping may need to help provide total water capacity during peak use periods to move water from the South Aquifer Well System to the North Area customers.

In 2008, the company retained Robinson Noble for a report whose scope of work included hydrogeologic services and consulting related to construction of Well No. 17 as an additional point of withdrawal at the Well No. 2 site.¹ The scope of work also included reporting on operational issues for Well No. 3. Robinson Noble's recommendation was to drill a new well at the existing Well No. 2 site located at 781 Walker Way at a projected cost of \$ \$180,000.

The Robinson Noble study had several key findings. Source production records for several years showed that Well No. 2 was declining and had unknown future capacity. The North Aquifer Well System is served by Wells No. 2, No. 3 and No. 4N. Well No. 2 was placed in-service in 1968 and had capacity to serve of 245 gallons per minute.²

If there were no future declines in Well No. 2 capacity, then the North Aquifer Well System, with all wells operational, was thought to have adequate source capacity for more than 20 years of growth based on then-current water demand analysis.

If Well No. 2 continued to decline and was ultimately taken out of production with no immediate replacement of source capacity, then Wells No. 3 and No. 4N had the ability to provide the current level demand capacity and an additional 37 Equivalent Residential Units.

Selection of the current site at 781 Walker Way met several key elements that had been outlined by various sources. The new well would use the existing aquifer source and would not require waiting for new source approval from DOE, which, based on backlogs for applications, could take several years. Shifting to a new site in the North Area was dismissed due to the highly variable geology and unknown water producing capabilities. Additionally, new property acquisition could be expensive and risky. The availability of a new, deeper aquifer was discussed based on uncertain existence and unknown depth or quantity of a new source. The current aquifer

¹ February 28, 2008 Scope of Work, Robinson Noble.

² 2005-2009 Annual report on the Port Ludlow area groundwater monitoring program for Port Ludlow Associates, LLC Pages 2-3.

of Well No. 2 was known and avoided the risks of drilling in a new area. Shifting the location to the South Aquifer Well System would require arsenic treatment of the water being provided to the North Aquifer Well System as well as new transmission infrastructure.

The company decided to use the existing site location at 781 Walker Way.³

Site selection at 781 Walker Way
(Attachment 2)

Consideration was given to the geologist's report (1991) on the underground storage tank (UST) removals done in 1990. This report noted several items to support the company's conclusion to use the existing site at 781 Walker Way.⁴

- No groundwater was encountered in the drilling of the borings at the site.
- A total of approximately 150 cubic yards of gasoline-contaminated soil were excavated from two (northern) UST locations.
- No detectable contamination was encountered around the southern 2,000-gallon tank.
- The low permeability sediments between the contaminated soil and the screened aquifer protect potable groundwater from contamination.
- The remaining soil contamination 'is surrounded by low permeability silty sand of sufficient thickness to protect the adjacent water well from migration of hydrocarbons into the public water supply.'
- The thick sequence of clay, silt, and cemented sand located above the water producing interval . . . should provide substantial protection of the water producing sand from any surface contamination.

Well No. 2 is located approximately 85 feet from the USTs, which were removed and contamination remediated in 1990, as noted above. Well No. 2 had declining capacity each subsequent year and Well No. 3 had declining water recovery issues⁵.

The company decided to drill Well No. 17 in the confirmed aquifer area approximately 110 feet to the southeast of the former garage and prior UST location. This distance is further than the Department of Health's (DOH) required 100-foot radius wellhead protection area for an active well providing drinking water to the public. Moreover, given the nature of the soils, as noted in the 1991 geologist's report, the company believed the location would be free of contaminants.

Well No. 17 review and investigation after contamination found in April 2009.

Shortly after drilling started on Well No. 17, contamination was discovered at the Well No. 17 site. Given this result, the company believed further investigation was necessary to determine if

³ Response Data Request 1, question 3, page 7.

⁴ Applied Geotechnology Inc., Hydrocarbon Contamination Assessment and Underground Storage Tank Removal, dated March 4, 1991.

⁵ August – October 2007, emails between Olympic Water & Sewer and Robinson, Noble & Saltbush.

Well No. 2 was at risk. Also, legal costs were incurred to determine the ramifications related to the contamination found at Well No. 17 and what actions would be required. To the extent the investigatory activities undertaken were useful and necessary to assessing risks to Well No. 2, those costs might be recovered in this filing.

Future Remediation of site

The company is not seeking funds for any remediation or future costs not yet known or measurable. Therefore, staff did not consider any remediation or future cost. The company has entered into a settlement agreement which provides for remediation cost up to a cap on certain obligations of \$1,000,000.⁶

The company seeks recovery of only those costs associated with (1) drilling Well No. 17 and (2) investigation and legal costs after the discovery of soil contamination.

Under the Model Toxics Control Act Cleanup Regulation for Washington, a current or past facility owner or operator is potentially liable for cleanup.⁷ Olympic Water and Sewer, or the company's predecessor corporations, have provided funds for drilling, investigation and legal costs to date. Some of these costs have also been shared with a third party for initial site characterization and technical investigation. The company filed an insurance claim that was denied by the insurer.

In staff's opinion, the company was pro-active in its response to Well No. 2 capacity issues and in seeking an additional source of water for the North Aquifer service area. The company selected 781 Walker Way and drilled Well No. 17. Staff believes the company is entitled to recovery from customers and outlines below the cost recovery portions and treatment. All costs shown below are based on after tax benefit, interest accrued and cost recovery allocations to third parties.⁸

Cost Recovery

Since the April 10, 2014, suspension date, the company and customers have had several meetings to discuss the surcharge filing. Commission staff attended one public meeting with customers held at Port Ludlow. The company has reached a compromise^{9 10} on cost recovery with the Port Ludlow Village Council¹¹.

⁶ Settlement Agreement between Olympic Water and Sewer, Inc., Port Ludlow Associates LLC, Olympic Property Group and Pope Resources, page 6 dated May 21, 2013.

⁷ Model Toxics Control Act, chapter 70.105D RCW and chapter 173-340 WAC.

⁸ Invoice Log of Company Spreadsheet Total cost of \$246,858.

⁹ Attachment 3, August 11, 2014, Letter from Olympic Water to Jim Ward, Compromise Proposal

¹⁰ Attachment 4, August 14, 2014, Letter from PLVC to Jim Ward, Supporting Compromise

¹¹ Port Ludlow Village Council (PLVC) Formed in 1999 as a representative body whose function is to foster and preserve the quality of life in Port Ludlow. PLVC can represent all property owners of the Port Ludlow Master Planned Resort (approximately 1,600) and functions very similar to a homeowners association with an elected council board with representatives elected based on population of the areas of North Bay, South Bay, and members representing the commercial and developer interest.

The following table shows the originally proposed cost recovery for well No. 17 with revisions and deferred items that were the product of meetings with stakeholders and UTC Staff.

Well No. 17	Proposed Cost	Revised Cost	Deferred Cost
Well Drilling	\$ 31,115	--	\$ 31,115
Site Investigation	\$ 69,844	\$ 69,844	--
Legal	\$ 47,475	\$35,606	\$ 11,869
Notice & Mailing	\$ 788	\$ 788	--
Utility Tax	\$ 4,543	\$ 1,737	--
Interest	\$ 13,398	\$ 9,534	--
Total	\$ 165,059	\$ 117,514	\$ 42,983
Annual Surcharge Amount	\$ 52,124	\$ 37,110	--
Monthly Surcharge Rate*	\$2.70**	\$1.92***	

* Annual Surcharge Amount ÷ 1,608 customers ÷ 12 months

**Surcharge expires June 30, 2017, or upon recovery of \$165,059, whichever occurs first.

*** Surcharge expires October 31, 2017, or upon recovery of \$117,514, whichever occurs first.

The compromise proposal is:

- Well No. 17 drilling cost: Defer all of the \$31,115 cost for future capitalization and recovery associated with a future new water supply source for the North Aquifer service area.
- Site Investigation cost: Recover all of the \$69,844 in the revised surcharge.
- Legal cost: Recover \$35,606 (75 percent) in the revised surcharge and defer \$11,869 (25 percent) for future capitalization and recovery associated with a future new water supply source for the North Aquifer service area.
- Notice & Mailing: All costs included in revised surcharge. (No change)
- Utility Tax: Adjusted to apply to revised costs in the revised surcharge.
- Interest: Adjusted to apply to revised costs in the revised surcharge.

Total amount in the revised proposal is \$117,514 for the current surcharge and \$42,983 deferred for future capitalization and recovery associated with a future new water supply source for the North Aquifer service area.

The revised surcharge would expire October 31, 2017, or upon recovery of \$ 117,514 whichever occurs first. Costs includes principal, plus interest charges and state excise taxes. Customers

could choose to pay, within 90 days of effective date, a one-time \$67.06 payment to avoid interest cost.

Customer Comments

On March 07, 2014, the company notified its customers of the proposed surcharge by mail. Staff received 50 comments regarding the proposed surcharge; 39 opposed to the surcharge and 11 in favor. Customers were notified that they may access relevant documents about this surcharge on the commission's website, and that they may contact John Cupp at 1-888-333-9882 or jcupp@utc.wa.gov with questions or concerns.

General Comments

- Customers who oppose the proposed surcharge believe they should not have to pay for what they consider poor business decisions. They believe Pope Resources or the water company should be responsible for all costs related to Well No. 17.
- Customers in favor of the surcharge believe the company made a good faith effort to increase water supply to the community. They are willing to pay the surcharge.

Staff Response

Staff informed the commenters that the proposed surcharge would be on the agenda of the May 29, 2014, open meeting, along with information about how to participate in person or by phone.

Conclusion

The company has filed to recover costs, under condition 8a of Order 01, that were deferred upon the commission approving the petition for accounting order on September 17, 2011.

While selection of the well site at 781 Walker Way by the company involved risk which the company knew based on previous reviews and acknowledgements of prior contamination, Staff believes that drilling well No. 17 was reasonable based on the need for an additional source and issues associated with wells No. 2 and No. 3. Moreover, the company drilled well No. 17 after considering the geologic report, the removal of the USTs and contamination remediation in 1990, the potential for future contamination, the proximity to Well No. 2, which was located closer to the 1990 UST site and showed no contamination, the location of Well No. 17 further from the 1990 UST site and further than DOH recommendation, and the costs of other identified options. Once drilling started and contamination was found the company immediately stopped drilling and began its investigations. Well No. 2 was tested and found to contain no contamination and the company expanded its investigation to the surrounding area to determine the extent of contamination.

Commission staff has reviewed the company's filing to recover the cost of drilling Well No. 17, investigation costs after the contamination was discovered, legal costs for reviews and

negotiations, and the cost of the company's notice to customers. Staff has also reviewed the compromise letter between the company and the Port Ludlow Village Council in support of the revised filing.

The compromise letter outlines the revised and deferred treatment proposal shown in the table of summary of cost recovery Well No. 17 above. The letter notes: "OWSI acknowledges that this compromise surcharge will be non-precedential as to any future rate-making of OWSI related to the subject property, soil or groundwater site contamination, or costs attributable to Well #2 or Well #17." "Further, OWSI is willing to commit to its customer base that if OWSI elects to drill a new water supply well at the property commonly referred to as 781 Walker Way, Port Ludlow, Washington and identified by Jefferson County Assessor's Tax Parcel No. 821084004 in the future, and encounters additional contamination, OWSI will not file for recovery of costs for future well drilling costs associated with an attempted well not placed into production, or environmental site investigation or remediation costs arising under or resulting from any such future well drilling."

Staff notes the following two conditions:

1. Allowance of deferred accounting makes no determination of ratemaking treatment of any deferred cost and does not constitute regulatory assurance that the deferred amount will be recovered, in whole or part, in any future rate proceeding.
2. Deferred accounting does not determine whether any of the company's decisions or incurred costs associated with drilling Well No. 17, or with investigating or remediating soil contamination were prudent, whether or not the company exercised due diligence in pursuing compensation from third parties for soil contamination, what portion of costs, if any, should customers ultimately bear, or how those costs, if any, should be recovered. All of these issues will be considered by the commission during any tariff revision proceeding in which the company seeks to recover deferred costs

Staff recommends approving the revised filing that will reduce the Well No. 17 surcharge from \$2.70 per month to \$1.92 per month for a period of 38 months.

Recommendations

1. Dismiss the Complaint and Order Suspending the Tariff Revisions filed by Olympic Water and Sewer, Inc., in Docket UW-110436 dated April 10, 2014.
2. Allow the revised rates and tariff revisions filed by Olympic Water and Sewer, Inc., on August 22, 2014, to become effective September 1, 2014.
3. Issue an Order Allowing Deferral of Well No. 17 drilling and partial legal cost to be included in the replacement source of supply for the North Aquifer Well System.