

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

ILIAD WATER SERVICE, INC.,

Respondent.

DOCKET UW-150311

NARRATIVE SUPPORTING
SETTLEMENT AGREEMENT

I. INTRODUCTION

1 This Narrative Supporting Settlement Agreement (“Narrative”) is filed pursuant to WAC 480-07-740(2)(a) on behalf of both Iliad Water Service, Inc. (“Iliad Water Service” or the “Company”) and staff of the Washington Utilities and Transportation Commission (“Staff”) (hereinafter collectively referred to as “Parties” and individually as “Party”). This Narrative summarizes the Settlement Agreement (“Settlement”); it does not modify any terms of the Settlement.

II. PROPOSALS FOR REVIEW PROCEDURE

2 The Parties do not request a hearing to present the Settlement. The Parties instead respectfully request a streamlined review of the proposed Settlement on a paper record. If the Commission requires a hearing, the Parties are prepared to present one or more witnesses to testify in support of the Settlement.

III. SCOPE OF THE UNDERLYING DISPUTE

3 The underlying dispute concerns Iliad Water Service’s proposed tariff revision to create a surcharge to recover the costs for the design and construction of a corrosion control treatment plant installed on its Alder Lake community water system. The corrosion control

treatment plant was necessary to meet water quality standards enforced by the Department of Health.

4 Iliad Water Service is a water company and a public service company subject to the jurisdiction of the Washington Utilities and Transportation Commission (“Commission”). At the initiation of this docket, the Company provided water service to 56 customers on two water systems located in Pierce and Snohomish Counties. On July 30, 2015, in Order 01 of Docket UW-150688, the Commission approved the transfer of control, by acquisition of stock and merger, of five water systems to Iliad Water Service, effective August 1, 2015. Following the merger, Iliad Water Service provides water service to 326 customers on seven water systems located in Clallam, Pierce, Kitsap, and Snohomish Counties.

5 Derek Dorland is owner and president of Iliad Water Service. Derek Dorland makes all final management decisions for the Iliad Water Service; he is ultimately responsible for the operations of the Company. Derek Dorland is the Company’s sole employee.

6 Iliad Water Service has contracted Iliad, Inc.—owned and operated by Dave Dorland, Sr., the father of Derek Dorland—to perform maintenance and operations services pursuant to the terms of a Management Contract. Iliad Water Service also entered into a fixed price contract with Iliad, Inc. for \$152,826 to finance and construct a corrosion control treatment plant needed to meet state water quality standards on the Company’s Alder Lake community water system—the subject of this docket is cost recovery for this corrosion control treatment plant. In addition to the formal relationships between Iliad Water Service and Iliad, Inc., David Dorland Sr. also occasionally takes on voluntary roles for Iliad Water Service, and provides “fatherly” general business advice to Derek Dorland.

7 Iliad Water Service has contracted Water Services Company—owned and operated by Sondra LeBaron, the sister of Derek Dorland—to perform its billing and bookkeeping services. These services are provided pursuant to a Billing Service Agreement.

8 On December 31, 2007, the Department of Health (“DOH”) notified Iliad Water Service that its Alder Lake community water system required corrosion control treatment to address copper levels that exceeded state and federal drinking water standards. On February 16, 2011, DOH approved the Company’s proposal to construct a corrosion control treatment plant (the “Plant”) to address the high copper levels. The Company submitted its Construction Completion Report to DOH on July 1, 2011, and DOH approved it on July, 6, 2011. The Plant was placed into service for the benefit of Alder Lake community water system customers in December 2011, after some additional water quality monitoring occurred to ensure that the Plant was operating properly.

9 On February 23, 2015, Iliad Water Service filed with the Commission a proposed tariff revision that would generate \$160,512 of additional revenue to recover costs for the Plant. The Company proposed to recover the Plant’s cost from the 35 customers of the Alder Lake community water system by providing each customer a choice between either: 1) a one-time \$4,586 surcharge, or 2) a ten-year financing, at 8.5% interest, via a monthly surcharge of \$57. The proposed effective date for the rate increase was April 1, 2015.

10 On March 26, 2015, the Commission issued a Complaint and Order Suspending the Tariff Revisions in which it found that Iliad Water Service’s initial filing did not adequately justify the proposed tariff revisions. The Commission determined that it should investigate and appraise the Company’s operations, accounts, practices, and activities to determine whether the proposed tariff revisions would result in rates that are fair, just, reasonable, and

sufficient. The Commission further determined that Iliad Water Service bore the burden of proof to show that the proposed rate increase is fair, just, reasonable, and sufficient.

11 On June 8, 2015, the Commission convened a prehearing conference before Administrative Law Judge Rayne Pearson, and made the discovery rules available to the Parties. No other Party intervened in the proceeding.

12 After the Company filed its direct testimony and responded to numerous discovery requests from Staff, the Parties engaged in settlement discussions. On August 6, 2015, the Parties requested that the Commission suspend the procedural schedule to enable them to negotiate a settlement without the need to file additional testimony. The Commission granted the request on August 7, 2014. On August 19, 2015, Staff notified the Commission that the Parties had reached a settlement in principle, and requested that the Commission provide the Parties with time to memorialize their agreement. The Commission granted the request on August 28, 2015, and directed the Parties to file a settlement agreement and supporting documentation, or a status report on their progress by September 4, 2015.

13 The Parties' full settlement agreement is reflected in the Settlement Agreement, which was entered into voluntarily to resolve all matters that were in dispute.

IV. SUMMARY OF PROPOSED SETTLEMENT

14 The Settlement resolves all of the issues in dispute between the Parties. The Parties agree that Iliad Water Service shall be allowed to recover the capital costs and rate case cost associated with the Plant's remaining useful life, which amounts to \$81,812. Iliad Water Service shall recover the \$81,812 via a monthly surcharge to all of its 326 customers for a term of eleven-and-a-half (11.5) years. The monthly surcharge, which includes 8.5% interests and B & O taxes, shall total \$3.00 per customer. Within seven (7) days of an order approving this Settlement becoming final, the Company shall file revised tariff sheets to

implement the monthly surcharge, and it shall issue a notice to all of its customers explaining the reasons for the monthly surcharge.

15 Additionally, the Parties agree that certain accounting transparency improvements shall occur. The Parties acknowledge that an affiliated interest exists between Iliad Water Service and Iliad, Inc., and that all dealings between these two companies are subject to the state laws and Commission rules governing affiliated interests as codified in Chapter 80.16 RCW and Chapter 480-110 WAC. The Parties also agree that Iliad Water Service shall disclose to the Commission all dealings between it and Water Services Company. Going forward, Iliad Water Service shall file with the Commission any new agreements for services, or modifications to previously executed agreements, between Iliad Water Service and Water Services Company.

V. STATEMENT OF THE PARTIES THAT THE SETTLEMENT AGREEMENT SATISFIES THEIR INTERESTS AND THE PUBLIC INTEREST

16 The Settlement represents a compromise of the positions of the two Parties. The Parties find it is in their best interests to avoid the expense, inconvenience, uncertainty, and delay inherent in a litigated outcome. Likewise, the public interest is served by concluding this dispute without the further expenditure of public resources for litigation expenses.

17 The Settlement further satisfies both Staff's interest and the public interest because it addresses the three areas of concern that Staff had with the Company's initial filing: accuracy of the Plant's cost, rate impact on individual customers, and inadequate accounting transparency to substantiate costs. First, Staff had concerns that the proposed tariff revision did not accurately reflect the capital cost for the Plant's construction. In support of the proposed tariff, the Company's initial filing contained only a single-page document that summarized the major cost categories (e.g., labor, materials, equipment, etc.) for the Plant.

In testimony, the Company also provided the fixed price contract with Iliad, Inc. for the financing and construction of the Plant, and a Job Ledger Report (the "Ledger") produced by Iliad, Inc. for work done on the Alder Lake community water system for the period of July 15, 2008, to May 31, 2014. While the total costs in the Ledger approximated the fixed price of the Iliad, Inc. contract, Staff could not verify the costs in the Ledger because the entries lacked sufficient detail to explain their relation to the construction of the Plant. Additionally, the Ledger included costs for a period of nearly six-years, even though the construction period for the Plant lasted approximately 6 months.

18 In discovery, Staff learned that Iliad, Inc.'s Ledger included operation and maintenance costs that were not properly included in a surcharge for the capital costs of constructing the Plant. Staff also verified with receipts many of the Plant's major construction costs. For costs known to have occurred but that could not be verified with receipts, Staff was satisfied to limit recovery to the costs identified in the Ledger that occurred during the six-month construction period. Regarding the asset life and recovery period of the Plant, Staff found that basic accounting and regulatory principles prevented the Company from recovering costs associated with the three-and-a-half (3.5) years since the Plant entered service and had depreciated. Staff agreed however that a total asset life of fifteen (15) years, rather than the initial filing's ten (10) years, more accurately reflected the Plant's true useful life. Of note, Staff visited the Plant and was impressed with the quality of the facility. Overall, both Staff's interest and the public interest is satisfied because the Settlement accurately approximates the capital cost and proper recovery period of the Plant.

19 Second, Staff was concerned about the impact that the proposed surcharge would have on each customer served by the Alder Lake community water system. These customers currently pay a flat rate for service of \$46.50 per month as well as a \$20.25 surcharge

(which expires in June 1, 2028) for the construction of a chlorination treatment facility built in 2008. An additional surcharge of \$57 per month for the Plant would have raised each customer's monthly bill to \$123.75—an increase of 85.4%.

20 The transfer of ownership of five additional water systems to Iliad Water Service that occurred on August 1, 2015, presented an opportunity to disperse the impact of the surcharge by employing single-tariff pricing. Single-tariff pricing is the use of a unified rate structure for a multi-system water company. It helps provide rate stability to all customers—much like insurance pooling—by dispersing the cost volatility that occurs across multiple water systems over time. The Commission routinely employs single-tariff pricing. At the time the Commission considered cost allocation for the chlorination treatment facility, however, Staff found that the rate impact on customers not served by the facility was too significant because it exceeded the 15% - 23% average rate impact range of Commission-approved surcharges.¹ Following the merger, the cost of the Plant can be allocated to a sufficiently large number of customers to limit the impact on each customer's monthly bill to \$3.00—an increase of only 5.8% on average. The rate stability gained by dispersing the impact of the surcharge satisfies both Staff's interest and the public interest.

21 Finally, Staff had concerns about inadequate accounting transparency to substantiate costs, which in turn raised questions for Staff as to whether Iliad Water Service's dealings with Iliad, Inc., and to a lesser extent Water Service Company, each owned by family members, were true arms-length dealings. Staff acknowledges that the Company's dealings with Iliad, Inc. provide certain material benefits to its customers. For instance, Iliad, Inc. provided the Company with financing for the Plant at a lower interest rate than was available

¹ See Docket UW-060343, Staff Investigation Report, Pages 22-24 (June 2007).

from commercial lenders. Staff nevertheless found that the distinction between family and business relationships blurred at times, which undermined the presumption of arms-length dealings between the three companies. In discovery, Staff's concerns amplified due to inadequate accounting transparency.

22 Staff finds that the Company's agreement to the accounting transparency improvement provisions of the Settlement should help bolster confidence in the dealings between the three companies, and enable faster and more accurate cost recovery filings in the future. In particular, Iliad Water Service's acknowledgment that an affiliated interest exists between itself and Iliad, Inc.—and that all dealings between these two companies are subject to the state laws and Commission rules governing affiliated interests—establishes clear expectations going forward about what constitutes satisfactory proof of costs incurred. Iliad Water Service must also file an annual report summarizing all transactions that occurred between the Company and Iliad, Inc. Furthermore, prior to the effective date of any new or modified contract with Iliad, Inc., the Company must obtain the Commission's approval that the contract is reasonable and consistent with the public interest.

23 Staff is satisfied with the Company's commitment to enhanced disclosure with regard to Water Services Company, as oppose to acknowledging that an affiliated interest exists, because the costs incurred for bookkeeping and bill services are less complex for Staff to audit. For instance, this filing included very few third party transactions with Water Services Company. In total, the accounting transparency improvement provisions of the Settlement satisfy both Staff's interest and the public interest because they establish expectations that should enable more straightforward cost recovery filings in the future.

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For these reasons, the Settlement as a whole is in the public interest, as well as the interests of the Parties. Staff and Iliad Water Service, therefore, recommend that the Commission approve the Settlement in its entirety.

VI. LEGAL POINTS THAT BEAR ON PROPOSED SETTLEMENT

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In WAC 480-07-700, the Commission states its support for parties' informal efforts to resolve disputes without the need for contested hearings when doing so is lawful and consistent with the public interest. The Parties have resolved all of the issues in dispute between them, and their resolution complies with Commission rules and, as explained above, is consistent with the public interest.

VII. CONCLUSION

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Because the Parties have negotiated a compromise on all of the issues in this dispute and because the Settlement is in the public interest, the Parties request that the Commission issue an order approving the Settlement in full.

Respectfully submitted this 4th day of September, 2015.

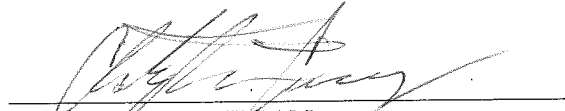
WASHINGTON UTILITIES AND
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For
Resent

Dated: Sept. 4, 2015

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