

Exhibit T-\_\_ (EKE-1T)  
Docket Nos. UW-031284/010961/  
031596 (consolidated)  
Witness: Gene Eckhardt

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

AMERICAN WATER RESOURCES,  
INC.,

Respondent.

DOCKET NO. UW-031284  
DOCKET NO. UW-010961  
DOCKET NO. UW-031596  
(consolidated)

TESTIMONY OF

Eugene K. Eckhardt

STAFF OF  
WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION

April 1, 2004

1 **Part 1 – Introduction**

2 **Q. Please state your name and business address.**

3 A. My name is Eugene K. Eckhardt. My business address is 1300 S. Evergreen Park  
4 Drive S.W., P.O. Box 47250, Olympia, WA 98504-7250.

5  
6 **Q. By whom are you employed and in what capacity?**

7 A. I am employed by the Washington Utilities and Transportation Commission  
8 (Commission) as the Assistant Director of Transportation and Water.

9  
10 **Q. How long have you been employed by the Commission?**

11 A. I have been employed by the Commission since September 1992.

12  
13 **Q. Please state your educational background.**

14 A I received a Bachelor of Arts degree, with majors in Economics and Mathematics,  
15 from the University of Colorado in 1973. I received a Masters in Business  
16 Administration from the University of Colorado, Denver in 1984. I attended the  
17 following seminars on regulation:

18 1992 NARUC Western Utility Rate School

19 1989 Rocky Mountain Program

1 University of Colorado at Denver  
2 Center for the Improvement of Public Management  
3 1986 Colorado State Supervisory Certificate Program  
4 1982 National Conference of State Transportation Specialists Regulatory  
5 Administration Seminar  
6

7 **Q. Please describe your current job duties.**

8 A. As the Assistant Director of Transportation and Water, I am responsible for the  
9 management and operation of the Transportation and Water Section in  
10 regulating water companies and various transportation industries.  
11

12 **Q. Please state your professional background.**

13 A. I have worked for the Commission as the Assistant Director of Transportation  
14 and Water since September 1992. Prior to that, I worked for the Colorado Public  
15 Utilities Commission for 19 years in various positions including six years as the  
16 Supervisor of the Transportation Rate Section and the last three years as the  
17 Chief of Transportation.

18 I testified in Federal Bankruptcy Court regarding Commission regulation  
19 involving a solid waste company, in various formal transportation cases before

1 the Colorado Public Utilities Commission, and in Denver District Court in a  
2 bankruptcy hearing involving a taxi company. I have also testified before both  
3 Colorado and Washington legislative committees on transportation regulation  
4 issues.

5  
6 **Q. What is the purpose of your testimony?**

7 A. I respond to issues raised by Virgil Fox in his testimony filed in this case.

8  
9 **Q. Do you have a comment regarding the overall tone and language in Mr. Fox's**  
10 **testimony?**

11 A. Yes. Mr. Fox states that his testimony has a critical tone, may seem "overly  
12 emotional," and reflects his "complete and utter frustration and emotional  
13 stress." Exhibit No. \_\_\_ (VRF-1T) at 4:22-23 and 5:1. I agree. Despite Mr. Fox's  
14 claim that he does not intend to sound caustic, his testimony is saturated with  
15 emotional, accusatory language, which I have not seen in testimony in my thirty  
16 years of experience with Commission regulation.

17 An example is Mr. Fox's comment that: "The staff makes the adjustment  
18 [regarding the Docket 010961 Account] under the rationale that the company  
19 flagrantly misused the funds in blatant disregard of the terms of the  
20 Commissions order." Exhibit No. \_\_\_ (VRF-1T) at 28:16-18. Mr. Fox does not

1 identify how he formed his opinion that Staff's rationale for the adjustment was  
2 based upon "flagrant misuse" and "blatant disregard." The only material Staff  
3 submitted for this adjustment is set forth in Mr. Ward's testimony, which is a  
4 colorless statement of fact. Exhibit No. \_\_\_ (JAW-1T) at 29-39; Exhibit No. \_\_\_  
5 (JAW-24T) at 36-51.

6 That said, I better understand Mr. Fox's frustration after reading his  
7 testimony. Mr. Fox's testimony discloses apparent misunderstandings and  
8 conflicts with the regulatory process and basic regulatory principles that can only  
9 result in failed expectations. I discuss these conflicts and misunderstandings in  
10 greater detail later in my testimony.

11  
12 **Q. Mr. Fox states that the mere fact that we are conducting this review in front of**  
13 **the Commission is clearly indicative of the inherent problems with the current**  
14 **system of oversight. Exhibit No. \_\_\_ (VRF-1T) at 4:2-3. Do you agree?**

15 **A.** No. The fact that the Commission has a formal case before it does not indicate an  
16 inherent problem with the current system of oversight. The formal hearing  
17 process is time consuming and expensive for everyone involved, but necessary  
18 when parties cannot agree. However, the fact that this is the third time that  
19 AWR has appeared before the Commission in a formal proceeding in the last six

1 years, I believe, indicates that there are serious problems with the way in which  
2 AWR conducts its business.

3 Including this proceeding, the Commission will have heard five formal  
4 cases in the water industry during the last eleven years, three involving AWR.  
5 Clearly, this pattern is not in the best interest of customers, AWR, or the  
6 Commission. I remain cautiously optimistic that with Mr. Fox's pledge to work  
7 to establish a new, cooperative work atmosphere with Commission Staff (Exhibit  
8 No. \_\_\_ (VRF-1T) at 45:7-13), we can resolve these matters in the future without  
9 the need of formal proceedings.

10  
11 **Q. Why do you focus on the way in which AWR is conducting business?**

12 A. Despite what Mr. Fox or Ms. Parker believe or say in their testimonies, there is  
13 nothing about Staff's positions, interpretations, or actions that is personal toward  
14 Mr. Fox, AWR, or AWR's consultants. Despite Mr. Fox's claims that someone  
15 may want to "get rid of" him (Exhibit No. \_\_\_ (VRF-1T) at 4:16), that Staff has  
16 made adjustments to penalize him or AWR, or that Staff is trying to "kill" deals  
17 to sell water systems (Exhibit No. \_\_\_ (VRF-1T) at 26:14 – 26:4), Staff's actions  
18 reflect our understanding of the proper regulatory treatment of the issues, many  
19 of which are more fully discussed in Mr. Ward's testimony in this case. Staff has

1 no desire to penalize anyone: the Company, the shareholders, or the customers.  
2 Our goal is to properly apply regulatory principles and make proper  
3 recommendations to the Commission to achieve an appropriate outcome. This  
4 regulatory treatment applies to all regulated water companies, not just AWR,  
5 and to all owners, not just Mr. Fox.  
6

7 **Q. Mr. Fox states: "The real tragedy in this case is that an individual with the best**  
8 **of intentions, a proven track record, impeccable reputation, and sufficient**  
9 **capital has been totally distrusted, demoralized and forced to the point of near**  
10 **bankruptcy." Exhibit No. \_\_\_ (VRF-1T) at 4:9-11. Do you agree?**

11 A. No. Once again, this is not a personal issue with Mr. Fox. The real tragedy is  
12 that customers have not received the level of water service they deserve. After  
13 eight years as an owner of a regulated water company, seven rate cases, four  
14 surcharge filings, and two formal rate hearings, it appears that Mr. Fox still does  
15 not understand basic regulatory principles.  
16

17 **Q. Please explain.**

18 A. Although AWR's corporate goal states that AWR will "pay particular attention to  
19 .... UTC regulations ....," Mr. Fox states that AWR has been unable "to achieve

1 rates that will allow AWR to serve it's (sic) customers properly..." due to "staff's  
2 interpretation of regulatory theories that often conflict with the normal practices  
3 and operations of small business operations." Exhibit No. \_\_\_ (VRF-1T) at 8:21-  
4 22, 9:21 to 10:2, and 10:3-5. Had Mr. Fox complied with and worked within the  
5 regulatory framework, he would have understood that regulated companies do  
6 not operate in the same manner as non-regulated small businesses.

7 In discussing AWR's taxes, Mr. Fox refers to losses from prior years being  
8 carried forward and describes that as "a feature of the tax laws that the  
9 Commission does not seem to recognize." Exhibit No. \_\_\_ (VRF-1T) at 13:20-23.  
10 Statements like this demonstrate Mr. Fox's apparent lack of understanding of  
11 regulatory principles, such as retroactive ratemaking. This misunderstanding is  
12 further illustrated by Mr. Fox's discussion of AWR's "inability to recover  
13 investment." Exhibit No. \_\_\_ (VRF-1T) at 42:19 to 43:8. Mr. Fox discusses AWR's  
14 inability to recover past operating losses, not investment, and mistakenly  
15 attributes this to Commission policy.

16 Mr. Fox states that Staff has always insisted that AWR cannot establish a  
17 reserve account for future costs. Exhibit No. \_\_\_ (VRF-1T) at 7:4-5. A reserve  
18 account is authorized by statute (RCW 80.28.022) for specific purposes, not  
19 Commission policy. Staff advises every water company, not just AWR, that they



1 cannot establish a reserve account for future, unknown expenses and future,  
2 unknown capital expenditures.

3 Further, Mr. Fox appears to believe that current rates are, or should be,  
4 designed to recover future capital expenses or non-quantifiable operating  
5 expenses. This is demonstrated by his testimony regarding “new costs that are  
6 coming” and “inevitable” significant repairs. Exhibit No. \_\_\_ (VRF-1T) at 6:7 and  
7 6:21-22.

8  
9 **Q. Mr. Fox states that his testimony reflects his “true belief and best explanation”**  
10 **of AWR’s history. Exhibit No. \_\_\_ (VRF-1T) at 5:12-13. Do you have any**  
11 **comments?**

12 A. Yes. The issues before the Commission in this case are to determine what should  
13 be done with the Docket 010961 Account and determine the proper level of rates  
14 for AWR to charge its customers. In my opinion, AWR’s past cases before the  
15 Commission have no relevance to the decision in this case. Each of those past  
16 cases was decided based upon the information available at the time, and many  
17 have substantial records. Those records are closed. This is not the proper forum  
18 to revisit or re-litigate those issues. However, the inflammatory nature of Mr.  
19 Fox’s testimony requires Staff to respond on the record.

1 Mr. Fox sets forth AWR's corporate goals in his testimony. Exhibit No.  
2 \_\_\_\_ (VRF-1T) at 8:14 to 9:14. The goals are ambitious, properly focused on the  
3 long-range, and, I believe, attainable. Utilities provide services that are affected  
4 with the public interest and are intended to be an ongoing activity.

5  
6 **Q. Mr. Fox stated that the UTC thinks that AWR expanded too fast and was**  
7 **under-capitalized. Exhibit No. \_\_\_\_ (VRF-1T) at 22:20-21. Is that true from**  
8 **Staff's perspective?**

9 A. Yes. AWR, and its predecessor Lewis County Utilities Corporation, purchased  
10 158 water systems between May 1996 and November 1998. Many of those water  
11 systems needed capital improvements when they were purchased. AWR's  
12 Capital Improvement Plan, prepared in 1998, lists 90 projects. Mr. Fox states that  
13 AWR moved "as fast as possible" to bring conditions up to standards and asked  
14 for rates to support the effort. Exhibit No. \_\_\_\_ (VRF-1T) at 19:11-13. However,  
15 many of those water systems still require capital improvements today. Exhibit  
16 No. \_\_\_\_ (EKE-2).

17 AWR's customer base grew from 40 in 1996, to 1,867 in 1998. The rapid  
18 growth appears to have stretched AWR's ability to provide quality service to its

1 customers. Customer complaints increased during and after the expansion  
2 period as follows:

| SUMMARY OF AWR<br>CUSTOMER COMPLAINTS |                   |
|---------------------------------------|-------------------|
| Year                                  | No. of Complaints |
| 1997                                  | 2                 |
| 1998                                  | 76                |
| 1999                                  | 44                |
| 2000                                  | 48                |
| 2001                                  | 7                 |
| 2002                                  | 2                 |
| 2003                                  | 4                 |

4  
5 The Commission also experienced increased comments from customers in  
6 response to rate increases proposed by AWR and increased customer  
7 participation at the Commission's Public Open Meetings to make comments to  
8 the Commissioners. Many customers were not satisfied with the water quality or  
9 service quality provided by AWR.

10 In Docket Nos. UW-980072, UW-980258, UW-980265 (consolidated), the  
11 Commission received sworn public comment from 35 participants including  
12 ratepayers and current and former legislative representatives elected from  
13 districts that include AWR customers. The Commission found that AWR's

1 quality of service was inadequate to meet the legitimate needs of its customers.  
2 Fifth Supplemental Order at 3, 5 – 6, and 48.

3 DOH also experienced increased customer complaints about slow  
4 response by the company to customer calls about system problems and DOH  
5 needed to issue orders and penalties for AWR to make immediate public health  
6 improvements. Exhibit T-\_\_\_ (DL-1T) at 12:9-18

7  
8 **Q. Mr. Fox states that Staff criticized AWR for purchasing or taking over a**  
9 **number of systems with serious problems and deficiencies, even though that**  
10 **was part of its business plan. Exhibit No. \_\_\_ (VRF-1T) at 19:5-7. Is that true?**

11 A. No. Staff did not criticize AWR's business plan or AWR's knowledgeable  
12 purchase of water systems that required capital improvements. In fact, the  
13 Commission has adopted a strategy to encourage consolidation of water systems,  
14 especially of troubled water systems. Staff did express concern that AWR (1)  
15 purchased water systems for which AWR had accurate information on required  
16 upgrades, but for which, AWR did not immediately make needed  
17 improvements; (2) continued to purchase additional water systems, some of  
18 which also required capital improvements, even as AWR's existing water  
19 systems went unimproved; and (3) purchased water systems for which Staff

1 understood AWR did not conduct sufficient due diligence and later found  
2 significant problems.

3  
4 **Q. Mr. Fox states that he did several things that were contrary to UTC's wishes,**  
5 **such as his purchase of the H2O system. Exhibit No. \_\_\_ (VRF-1T) at 18:6-7**  
6 **and 18:10-18. Please comment.**

7 A. Staff opposed AWR's proposed purchase of the H2O system financed with 100%  
8 debt because of the effect on the Company's cash flow. However, Staff  
9 recommended the Commission approve AWR's purchase of the H2O system  
10 financed with debt equal to the existing rate base and equity for the amount of  
11 the purchase price that exceeded the rate base.

12 Although Mr. Fox states that he purchased H2O "well below reasonable  
13 market value" (Exhibit No. \_\_\_ (VRF-1T) at 18:13), the Commission uses  
14 historical cost, minus accumulated depreciation and CIAC, to determine the  
15 appropriate rate base for setting rates. In Docket Nos. UW-980072, UW-980258,  
16 UW-980265 (consolidated), Mr. Fox was asked whether the Commission would  
17 allow various costs to be recovered in rates, and he responded, "That was an  
18 issue, and the final result of that I really leave to the accountants and attorneys to  
19 take care of how we allocate things in the books, how it gets done in the book."

1 Docket Nos. UW-980072, UW-980258, UW-980265 (consolidated), Transcript Vol.  
2 3, at 308:23 to 309:5.

3  
4 **Q. Another example Mr. Fox gives as an action contrary to the UTC's wishes was**  
5 **his stock purchase of the Country Water System. Exhibit No. \_\_\_ (VRF-1T) at**  
6 **18:19 to 19:4. Please comment.**

7 A. I disagree with Mr. Fox's statement that Staff said he could not purchase Country  
8 Water at the proposed \$190,000 purchase price. As I recall, Staff once again  
9 advised AWR that we would recommend the Commission not approve the  
10 purchase if AWR financed the entire purchase price with debt because of the  
11 effect on AWR's cash flow.

12 I also disagree with Mr. Fox's statement that the "wisdom of my decision  
13 [to purchase Country] was proven out when, in 1999, I sold the system for  
14 \$420,000, the total proceeds of which I plowed back into loans to American Water  
15 Resources." Exhibit No. \_\_\_ (VRF-1T) at 18:23 to 19:3. This statement illustrates  
16 Mr. Fox's business philosophy and his fundamental misunderstanding of utility  
17 service and utility regulation. Mr. Fox explains that he was, and still is, a  
18 developer before he got into the water business. I understand the buy-and-sell  
19 philosophy of a developer; that is how a developer makes money. However, the

1 water utility business is different than the developer business. Water utilities  
2 provide essential services and are intended to be ongoing, long-term enterprises.

3 Mr. Fox purchased Country Water through a stock purchase, which the  
4 Commission did not regulate at the time, and sold it several years later for a  
5 personal profit. Although Staff does not believe those transactions were in the  
6 best interest of the customers, I am not aware of any Staff member who was  
7 "infuriated" by Mr. Fox's actions. The Commission now regulates stock  
8 purchases.

9  
10 **Q. You have discussed AWR's water system purchases. AWR also sold water**  
11 **systems to Peninsula Light, and Mr. Fox states that the Commission**  
12 **"impounded" and restricted the use of the income from the sale. Exhibit No.**  
13 **\_\_\_ (VRF-1T) at 13:17-18. Please comment.**

14 In June 2001, AWR sold 21 water systems to Peninsula Light in Docket  
15 UW-010417 that resulted in an \$113,986 gain on sale. AWR and Staff signed a  
16 Settlement Agreement that allocated the gain on sale between AWR shareholders  
17 and customers. The portion of the gain on sale allocated to customers was  
18 \$110,856. AWR later filed revised rate base information for the water systems

1 sold and the Commission adjusted the gain on sale, with the customer portion  
2 adjusted to \$92,753.

3 AWR was required to hold the customer's portion of the gain on sale in a  
4 Capital Improvement, Contribution in Aid of Construction Account. The  
5 agreement required AWR to use those funds only for capital improvements  
6 approved or required in writing by the Department of Health under the Safe  
7 Drinking Water Act. AWR could use the funds for other appropriate expenses  
8 approved by a letter from Commission's Executive Secretary. Expenditures from  
9 the reserve account were also required to be treated as customer contributions  
10 for ratemaking purposes. Unlike Mr. Fox's assertion that the Commission  
11 "impounded" the funds from the sale to Peninsula Light, the treatment of the  
12 proceeds was due primarily to a settlement agreement. Exhibit No. \_\_\_ (VRF-1T)  
13 at 13:17-18.

14  
15 **Q. How was the money spent?**

16 A. The Commission approved AWR's request to spend \$66,422 of the funds and  
17 \$26,770 remains in the account.



1 **Q. Mr. Fox states that AWR sustained continuing losses, which he demonstrates**  
2 **by showing the losses that AWR reported on its annual reports and tax returns.**  
3 **Please comment.**

4 A. The Commission relies on audited financial records that reflect rate making  
5 principles to set rates, not unaudited annual reports or tax returns. For example,  
6 Docket No. UW-010961 was a general rate increase case in which AWR used a  
7 twelve-month test period of calendar year 2000. The following table shows the  
8 losses on AWR's unaudited UTC annual report and AWR's tax return that Mr.  
9 Fox refers to in his testimony (Exhibit No. \_\_\_ (VRF-1T) at 13:17-18) and the  
10 audited, restated per books numbers from the results of operations statement in  
11 Docket No. UW-010961.

| <b>Year</b> | <b>AWR UTC<br/>Annual Report<br/>(Unaudited)</b> | <b>AWR's Corporate<br/>Tax Return</b> | <b>Docket UW-010961<br/>Restated Per Books<br/>(Audited)</b> |
|-------------|--|---------------------------------------|--|
| 2000        | (\$231,352)                                      | (\$147,323)                           | (\$98,066)   |

13  
14 Losses reported on tax returns or on unaudited annual reports are not the  
15 same as losses incurred in providing regulated water service. Profits and losses  
16 are a function of both revenues and expenses. The Commission sets rates using  
17 historical costs, adjusted for known and measurable changes not offset by other

1 factors. Rates are prospective. Revenues, expenses, or both may be higher or  
2 lower than projected.

3 Some operating costs (e.g. power, testing requirements, chemicals, etc.)  
4 are beyond AWR's ability to control. If they increase above the levels used to set  
5 rates, revenues may not be sufficient to cover those expenses.

6 Some operating costs are within AWR's ability to control. For example,  
7 Mr. Fox testified that although the Commission previously determined the  
8 appropriate management salary level to be included in rates was \$17,000  
9 annually, AWR actually paid Mr. Fox \$5,000 per month, or \$60,000 annually.

10 Docket Nos. UW-980072, UW-980258, UW-980265 (consolidated), Transcript Vol.  
11 3 at 308:2 – 7. Ms. Parker testified at the hearing on September 22, 1998, that Mr.  
12 Fox had continued to receive \$5,000 per month in salary even after AWR had  
13 scaled back operations in May or June because of inadequate income. Docket  
14 Nos. UW-980072, UW-980258, UW-980265 (consolidated), Transcript Vol. 3 at  
15 152:19 through 153:15. The rates set by the Commission were not intended to  
16 provide sufficient revenue to pay \$5,000 per month in management salary. The  
17 difference (\$3,583 per month) would likely show up as a loss on AWR's  
18 unaudited annual report and tax return. The difference (\$3,583 per month)

1 would be removed as a restating adjustment on AWR's audited, restated per  
2 books results of operations used to set rates.

3 Costs, such as engineering associated with capital investment projects,  
4 that are recorded as expenses would likely contribute to a loss on AWR's  
5 unaudited annual report and tax return. Those costs would be removed as a  
6 restating adjustment on AWR's audited, restated per books results of operations  
7 used to set rates.

8 AWR purchased some water systems for amounts greater than rate base.  
9 In Docket Nos. UW-980072, UW-980258, UW-980265 (consolidated), the  
10 Commission concluded that AWR failed to demonstrate that customers received  
11 a benefit commensurate with the premium amount paid over rate base and did  
12 not allow that amount to be included in rate base. AWR still needed to make  
13 interest and principal payments for the portion of debt associated with the  
14 negative acquisition adjustment. The cost to service debt that is not supported  
15 by rates would likely show up as a loss in AWR's unaudited annual report and  
16 tax return, but would not be shown as a loss on AWR's audited, restated per  
17 books results of operations used to set rates.

18  
19 **Q. Mr. Fox states: "To further display this total disregard for funding of our**  
20 **deferred maintenance, we should look at our 1999 surcharge request. We had**

1 prepared a capital improvement budget as required by DOH (Detailed in our  
2 1996 Water System Plan on file with DOH) and we identified over 90 needed  
3 upgrades. UTC staff dictated that only the few (13) projects that were directly  
4 health related should be funded. The remainder had to be left as time bombs  
5 waiting to explode. No rationale or explanation was presented.” Exhibit No.  
6 \_\_\_ (VRF-1T) at 29:18 to 30:3. Do you agree with Mr. Fox’s characterization of  
7 the events surrounding the 1999 surcharge?

8 A. No. I was involved with the development of the surcharge, but have a different  
9 recollection of the process. There were a number of meetings with AWR, UTC,  
10 and DOH. The process and the reasons were clear.

11 Mr. Fox proposed a surcharge to fund 90 projects listed in AWR’s revised  
12 Capital Improvement Plan, as prioritized by AWR. Staff felt the list was overly  
13 ambitious, so we asked DOH if the proposed project list was appropriate and if  
14 the projects were properly prioritized. Everyone, including AWR, wanted to  
15 move as quickly as possible, so we agreed to focus on what DOH identified as  
16 the critical projects. Commission Staff did not insist on any restrictions  
17 regarding the number or types of projects. Had DOH said all 90 projects were  
18 critical, the surcharge would have included all of the projects and taken much  
19 longer to get started.

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**Q. Did AWR experience problems in completing the projects?**

A. Yes. I refer the Commission to Denise Lahmann's testimony, which describes actions taken by DOH to assess penalties based on AWR's failure to produce project reports and submit construction documents, to install chlorination equipment, to install certain facilities, to install disinfection equipment, to submit a corrosion control recommendation report, and to sample for lead and copper. Exhibit No. \_\_\_ (DL-1T) at 18:14 to 19:4.

**Q. Mr. Fox testified that V.R. Fox Company, LLC, an affiliate construction company, completed the surcharge jobs "at a very substantial savings of approximately \$121,435 to AWRI customers." Exhibit No. \_\_\_ (VRF-1T) at 15:19; Exhibit No. \_\_\_ (VRF-7). Please comment.**

A. The V.R. Fox Company, LLC's bids were the lowest bids in all cases. However, not all of the work originally bid was completed. DOH later agreed to reduce the scope of work on several projects. In March 2000, AWR asked the Commission to extend the surcharge to allow recovery of an additional \$102,106. The Commission suspended the proposed tariffs in Docket UW-000405, and later dismissed the filing because AWR failed to present sufficient and reliable

1 evidence on which to determine whether (1) its labor and material costs and (2)  
2 its engineering costs should be recovered from the surcharge funds.

3 In June 2001, AWR filed to increase the surcharge amount from the  
4 original \$380,350 to \$659,589, by extending the expiration date four and a half  
5 years from May 1, 2005, to December 1, 2009. Docket No. UW-010866. AWR  
6 asked to recover an additional \$279,239. The purpose of that filing was to  
7 recover cost overruns. AWR stated that actual construction costs exceeded the  
8 original estimates, even with less work completed, and submitted backup  
9 information on actual construction costs. When asked in Docket No. UW-000405  
10 about the reason for the difference between V.R. Fox Company, LLC's bids and  
11 the contract costs, Mr. Fox testified, "this whole thing was done on a rush basis,  
12 and it was done on a relatively sloppy basis, and it was done on the basis when  
13 you are the low bidder, you are the low bidder, and you don't have to go  
14 through miles of justification of all of the things that have happened." Docket  
15 No. UW-000405, Transcript Vol. VI at 199:20-25. The Commission approved an  
16 extension of the expiration date to allow recovery of \$406,273, an increase of  
17 \$25,923:

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|  | <u>Current</u> | <u>Proposed</u> | <u>Revised</u> |
|--|----------------|-----------------|----------------|
| Loan Principal                           | \$380,350      | \$659,589       | \$406,273      |
| Interest Rate                            | 9.29%          | 7.25%           | 7.25%          |
| Expiration Date                          | 05/01/2004     | 12/01/2009      | 12/31/2006     |
| 1999 DOH Critical Item<br>List Surcharge | \$ 4.54        | \$ 4.54         | \$ 4.54        |

10 **Q. Mr. Fox discusses events surrounding the 1999 surcharge projects that AWR**  
11 **constructed through an affiliate company, V.R. Fox Company, LLC and**  
12 **testified that Staff criticized him for inter-company transactions (15:21) and**  
13 **audited every detail. Exhibit No. \_\_\_ (VRF-1T) at 15:15 to 16:11. Please**  
14 **comment.**

15  
16 **A.** Staff always reviews affiliate transactions in greater detail. Our goal is to ensure  
17 that regulated companies pay fair prices for services purchased from affiliates.  
18 We can demonstrate that by carefully auditing those transactions.

19  
20 **Q. Did Staff recommend additional measures in the 1999 Surcharge case that it**  
21 **might not have recommended under different circumstances?**

22 **A.** Yes. Due to the high number of customers expressing concern, and Staff's  
23 experience in Docket Nos. UW-980072, UW-980258, UW-980265 (consolidated),

1 Staff recommended the additional bidding restrictions. Staff has not found it  
2 necessary to recommend similar restrictions with other water companies.

3

4 **Q. Does AWR purchase services from other affiliates that Staff scrutinized**  
5 **closely?**

6 A. Yes. AWR purchases office space and, in the past, leased vehicles from affiliates,  
7 and Staff also carefully reviewed those affiliate transactions.

8

9 **Q. Please comment on AWR's ability to complete the projects funded by the**  
10 **surcharge.**

11 A. The results were positive. AWR completed the revised scope of work to DOH's  
12 satisfaction. In Docket UW-000405, in response to a question if AWR was in  
13 compliance, Bill Liechty, then DOH Regional Manager for Southwest Drinking  
14 Water Operations, testified that AWR was making progress and was doing a  
15 reasonably good job. Docket UW-000405 Transcript Vol. 7 at 278:18 to 279:8.

16

17 **Q. Do you know of any other specific attempts by AWR to obtain funding for**  
18 **additional capital improvement projects?**



1 A. Yes. AWR applied for a loan from the State Revolving Fund in 1998. I appeared  
2 before the Public Works Board to assure them that the Commission would  
3 structure a surcharge to ensure that AWR had the funds needed to pay back a  
4 loan. The Public Works Board did not approve the application. The Board Staff  
5 report stated the site visits raised questions about the public benefit of the  
6 proposed projects, and Board Staff found it difficult to get correct financial  
7 information from AWR. Board Staff recommended that AWR continue working  
8 to improve its financial position, more carefully assess the needs of the water  
9 systems, prepare an updated water system plan to include recent growth and  
10 reapply in a future loan cycle.

11  
12 **Q. Mr. Fox testifies that he established United Utilities, LLC, due to Staff's**  
13 **criticism of the "inherent...bookkeeping complication" that occurs when a**  
14 **utility has both regulated a non-regulated operations. Exhibit No. \_\_\_ (VRF-**  
15 **1T) at 34:10-13. Does Staff have a problem with AWR providing non-regulated**  
16 **services?**

17 A. No. In fact, most regulated companies conduct some non-regulated activities.  
18

1 **Q. If a regulated company conducts non-regulated activities, does that create an**  
2 **“inherent bookkeeping complication”?**

3 A. Yes. The company’s books need to be maintained in a manner that will allow  
4 Staff to separate the regulated and non-regulated results. Staff’s only interest is  
5 to ensure that regulated water customers do not pay costs associated with non-  
6 regulated activities. That is accomplished during a rate case by allocating costs  
7 between regulated and non-regulated activities. In Docket Nos. UW-980072,  
8 UW-980258, UW-980265 (consolidated), Staff questioned AWR’s SMA allocations  
9 principally because Staff felt that we were not provided the data in a form that  
10 we could audit. The Commission resolved the allocation issue in favor of AWR’s  
11 proposed method in that case. I am not aware of any subsequent issues with the  
12 SMA allocations.

13  
14 **Q. Mr. Fox testifies that the UTC and DOH have consistently refused to allow**  
15 **United Utilities, LLC to gain approval as a Satellite Management Agency.**  
16 **Exhibit No. \_\_\_ (VRF-1T) at 34:15-17. Does the Commission or Commission**  
17 **Staff have any role in approving a Satellite Management Agency?**

18 A. No. The Department of Health has sole jurisdiction over Satellite Management  
19 Agency status.

20

1 Q. Mr. Fox testifies that Staff has asserted that Mr. Fox could not pay himself a  
2 reasonable wage due to his role as an owner and that an owner cannot be a  
3 manager. Exhibit No. \_\_\_ (VRF-1T) at 33:21-22. Please respond.

4 A. I have never heard anyone on Staff say an owner could not be a manager. For  
5 small water companies, owners typically also work as managers. However, an  
6 owner receives compensation through return of and return on the owner's  
7 investment, not through a salary. An owner who works for the water company  
8 is an employee and is entitled to a reasonable salary for work performed.

9  
10 Q. Is there any inherent conflict in an owner making management decisions?

11 A. Yes. Management should make decisions that best serve the customer and the  
12 company. Not all management decisions affect customers and owners equally or  
13 in the same way. Sometimes the best decision for the company and the  
14 customers may not be the best decision for the owner. For example, AWR paid  
15 Mr. Fox significantly more in salary and interest than the Commission allowed  
16 for the purpose of setting rates. In 1998, AWR paid Mr. Fox \$5,000 per month in  
17 salary when the Commission set rates using \$1,417 per month. Docket Nos. UW-  
18 980072, UW-980258, UW-980265 (consolidated), Transcript Vol. 3 at 308:2 – 7. In  
19 July 2001, AWR was still paying Mr. Fox 12% on his personal debt, when the

1 Commission had allowed 10.5% in rates. Docket Nos. UW-980072, UW-980258,  
2 UW-980265 (consolidated), Sixth Supplemental Order at 6 and 35.

3  
4 **Q. Does that mean that owners should not or cannot be managers?**

5 A. No. However, everyone needs to be aware of the potential conflict and pay  
6 greater attention to ensure that decisions are made appropriately.

7  
8 **Q. You testified that an owner is entitled to receive compensation for work**  
9 **performed. Mr. Fox testifies that he has not been properly compensated for**  
10 **the work he has performed. Exhibit No. \_\_\_ (VRF-1T) at 13:1-4. Please**  
11 **respond.**

12 A. The Commission has addressed Mr. Fox's salary in several different rate cases.  
13 Each of those cases was settled by agreement or decided on the merits of the  
14 record. Some of the cases were formal cases with substantial records developed  
15 by both Staff and AWR.

16 Staff recommends that the Commission consider what the customers  
17 receive for the management compensation they pay in rates. The Commission  
18 previously found that AWR's customers have been long-suffering, and the  
19 capital structure laden with excessive debt created a burden on customers,

1 contributing to their suffering. Docket Nos. UW-980072, UW-980258, UW-980265  
2 (consolidated), Fifth Supplemental Order; Sixth Supplemental Order. The  
3 Commission consistently approved rates that included additional funds AWR  
4 represented it needed to hire additional employees to adequately serve its  
5 customers, but AWR did not always use those funds to hire the additional  
6 employees. DOH issued compliance orders and penalty assessments to AWR for  
7 failure to maintain its water systems in compliance with DOH standards.  
8 Customers on the Crowder Water System, faced months of “boil water” notices  
9 and successfully sued AWR. AWR has failed to complete the water system plan  
10 update that was due in 2003, as required by DOH. AWR has not fully used the  
11 funds in its Facilities Charge and Peninsula Gain on Sale account to make capital  
12 improvements for the benefit of customers, as demonstrated by the cash balances  
13 in those accounts. AWR sold its most profitable system to raise cash, resulting in  
14 the remaining customers absorbing higher per unit costs. AWR estimates a loss  
15 of \$15,000 revenue and savings of \$2,000 to \$3,000, a net cost to remaining  
16 customers of approximately \$12,000 to \$13,000 per month, or about \$7.99 per  
17 month, per customer as a result of the sale of View Royal. Mr. Fox states that he  
18 does not make any significant decisions without approval from his attorney or  
19 accountant, and he recognizes that practice increases consulting fees, which

1 increase rates to customers. Regular, formal rate case hearings have driven up  
2 rate case costs, requiring customers to pay higher rates. Customers should not  
3 bear the increased cost of AWR conducting its business through formal rate  
4 proceedings. In my opinion, these facts, taken together, point to a continuing  
5 pattern of ineffective management. I agree with Mr. Fox that AWR needs to  
6 conduct its business differently. Exhibit No. \_\_\_ (VRF-1T) at 45:7-13. Until that  
7 happens, Staff recommends that customers should not pay higher rates for  
8 ineffective management.

9  
10 **Q. Mr. Fox testifies that the Staff claims that he was making an unreasonable**  
11 **profit, but the exact opposite is true, and that Staff "often implies" that he is**  
12 **hiding excess profits. Exhibit No. \_\_\_ (VRF-1T) at 15:1-2 and 26:12. Please**  
13 **comment.**

14 **A.** I do not know what Mr. Fox means when he claims that Staff often implies that  
15 he is hiding excess profits. Staff has twice asked the Commission to review the  
16 level of AWR's rates. First, in Docket Nos. UW-980072, UW-980258, UW-980265  
17 (consolidated), Staff stated that we believed AWR's rates were too high, and the  
18 Commission decreased AWR's rates. Second, in this proceeding, Staff asked the  
19 Commission to review AWR's rates along with determining what should be

1 done with the set-aside funds associated with the Docket 010961 Account. In a  
2 third case, Docket No. UW-010961, the Commission allowed a rate increase, but  
3 ordered a portion set aside to be used only to hire additional personnel. Using  
4 average rates, the amount remaining after the set-aside was less than the rates in  
5 effect prior to the rate case. In other words, AWR's rates were too high for its  
6 ongoing operations without hiring additional employees.

7  
8 **Q. Mr. Fox testifies that Staff's treatment of its legal and accounting expense**  
9 **equates to Staff chastising AWR. Exhibit No. \_\_\_ (VRF-1T) at 25:17-18. Please**  
10 **respond.**

11 A. Mr. Ward sponsors Staff's recommendation with regard to AWR's legal and  
12 accounting expenses. Exhibit No. \_\_\_ (JAW-1T) at 13:8 to 15:5. Mr. Ward's  
13 recommendation is based on Staff's understanding of the appropriate treatment  
14 of expenses incurred by a company negotiating a sale. Staff's concern is not  
15 related to the expenses themselves, but to AWR's position that ratepayers should  
16 pay those expenses in general rates. Staff interprets these expenses as  
17 inappropriate for ratepayers to pay, and that interpretation applies to every  
18 regulated water company and all shareholders. There is nothing unique or

1 different regarding AWR or Mr. Fox. Staff does not seek to punish anyone. Our  
2 goal is to apply regulatory principles in a fair and reasonable manner.

3 In addition, Ms. Parker agrees with Staff's adjustments regarding legal  
4 and accounting expenses incurred during sales negotiations. Exhibit No. \_\_\_\_  
5 (JMP-1T) at 10:22 to 11:23  
6

7 **Q. Mr. Fox testifies that Staff did not consider the fact that AWR used the**  
8 **proceeds from the sale of the View Royal water system to pay off debt owed to**  
9 **Mr. Fox. Exhibit No. \_\_\_\_ (VRF-1T) at 28:9-11. Please respond.**

10 A. Mr. Fox is correct that Staff gave no consideration to how he used proceeds of  
11 that sale. Proper regulatory treatment has nothing to do with how the proceeds  
12 are used. When a company sells an asset, the company should retire the capital  
13 associated with that asset and any liabilities that customers on the system are  
14 responsible to pay. AWR paid off debt equal to the rate base associated with the  
15 View Royal system, which was appropriate. The View Royal sales price  
16 exceeded the View Royal rate base by \$335,550. Mr. Fox decided to pay down  
17 debt that AWR owed him. The result is that Mr. Fox no longer holds debt; he  
18 now holds equity.  
19



1 Q. Mr. Fox testifies that Staff micromanages AWR and controls how AWR  
2 spends its money. Exhibit No. \_\_\_ (VRF-1T) at 24:13-15. Does the  
3 Commission Staff have absolute control over company spending?

4 A. No. Staff does not have control over how AWR spends any of its money.  
5

6 Q. Does the Commission have absolute control over “every penny AWR spends”?

7 A. No. The Commission does control a small portion of funds and spending by  
8 directing funds to separate accounts to be used only for specific purposes. In  
9 addition, if Mr. Fox is referring to the rate setting process that determines how  
10 much revenue AWR receives from rates, rate setting is very different than having  
11 “absolute control of where and how every penny is spent.” In the rate setting  
12 process, the Commission determines AWR’s prudent, reasonably incurred  
13 expenses during a twelve-month test period, adjusted by known and measurable  
14 pro forma expenses not offset by other factors, plus an amount that represents an  
15 opportunity to earn a reasonable return on investment equals AWR’s revenue  
16 requirement. Rates are designed to generate AWR’s revenue requirement.  
17

1 **Q. Isn't that controlling what the company spends?**

2 A. No. Setting rates does control how much revenue AWR will receive, but it has  
3 nothing to do with how, when, or on what AWR spends its revenue.

4  
5 **Q. You testified that the Commission does control a small amount of revenue and**  
6 **expenses. Please explain.**

7 A. Sometimes a company will ask the Commission to approve a rate to pay for a  
8 specific purpose, such as a Facilities Charge to pay for growth related capital  
9 costs, or a Surcharge to pay for a loan obtained to construct capital projects. If  
10 the Commission approves those rates, the Commission will direct the company  
11 to keep the funds in a separate account and use the funds to pay only for the  
12 intended purposes instead of going into the company's general revenue account.

13  
14 **Q. Is that unusual for water companies?**

15 A. No. Many of the water companies the Commission regulates have some type of  
16 facilities charge or surcharge that the Commission has directed the company to  
17 use for specific purposes. The majority of the companies with facilities charges  
18 or surcharges have no problems with complying with the terms and conditions  
19 placed on the use of the money. Facilities charges and surcharges are useful

1 because they provide companies with a means to pay for capital projects that  
2 benefit customers.

3  
4 **Q. Has the Commission directed AWR to use specific dollars to pay for specific**  
5 **purposes?**

6 A. Yes. The Commission directed AWR to use specific dollars to pay for specific  
7 purposes on four different occasions. The first occasion was in Docket Nos. UW-  
8 980072, UW-980258, UW-980265 (consolidated). The Commission approved a  
9 \$1,860 facilities charge and directed AWR to maintain those funds in a separate  
10 account. AWR was required to use those funds “to benefit existing customers.”  
11 Docket Nos. UW-980072, UW-980258, UW-980265 (consolidated), Fifth  
12 Supplemental Order at 5; Sixth Supplemental Order at 36.

13 The second occasion was in Docket No. UW-990518. AWR asked the  
14 Commission to approve a \$4.54 monthly surcharge to pay principal and interest  
15 on a loan that AWR would use to make specific capital improvements. The  
16 Commission approved the surcharge, directed AWR to deposit the funds  
17 collected from the surcharge into a separate account, and directed AWR to use  
18 those funds only to pay the principal and interest on the associated loan. As Mr.  
19 Fox testified, AWR failed to make the appropriate deposits into this account.  
20 Exhibit No. \_\_\_ (VRF-1T) at 17:20-23.

1           The third occasion was in Docket No. UW-010417. AWR asked the  
2           Commission to approve the sale and transfer of 21 water systems to Peninsula  
3           Light. AWR and Staff signed a Settlement Agreement establishing the method of  
4           allocating the gain on sale between AWR shareholders and AWR customers. The  
5           Commission approved the Settlement Agreement and directed AWR to place the  
6           customer's portion of the gain on sale into a separate account, directed AWR to  
7           spend the funds only for capital improvements, and required AWR to obtain  
8           Commission approval before making expenditures.

9           The fourth occasion was in Docket No. UW-010961. AWR filed a rate case  
10          asking, among other things, that the Commission approve a rate increase so it  
11          could hire additional personnel. The Commission adopted a Settlement  
12          Agreement, signed by AWR and Staff, and approved AWR's request for funds to  
13          hire additional personnel, directed AWR to place the funds in a separate account,  
14          and directed AWR to spend the funds only if it hired additional personnel.

15  
16   **Q.    Why did the Commission require that AWR obtain Commission approval**  
17   **before making expenditures in the Docket UW-010417, Peninsula Light sale?**

18   **A.**   Based upon our experience with AWR mishandling surcharge funds, Staff  
19          recommended this additional protection, which was incorporated into the  
20          settlement agreement that AWR agreed to and the Commission approved.

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**Q. Why did Staff recommend the additional restrictions in Docket No. UW-010961 to place the funds in a separate account and to use the funds only if AWR hired additional personnel?**

A. That was the third time that AWR asked the Commission to approve rates that included additional funds to hire additional personnel to enable AWR to provide improved service to its customers. In the first two dockets, UW-980253 and UW-991392, the Commission approved rates that included pro forma expense adjustments for additional funds to hire additional personnel as AWR requested. In both cases, AWR did not hire the additional personnel on a full time basis. Therefore, Staff recommended that the Commission place additional conditions on the funds AWR collected from ratepayers to ensure that AWR actually used the money to hire additional personnel.

**Q. Are those restrictions unusual?**

A. Yes. Over a five-year period, the Commission set greater restrictions to try to ensure that AWR spent the money on the intended purpose. AWR is the only regulated water company for which the Commission has issued such specific direction.

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**Q. Mr. Fox states that the conditions put on the Company in Docket UW-010961 were entirely too stringent and after the View Royal System was sold, AWR simply could not adhere to the order. Mr. Fox states that AWR requested these conditions be reviewed and changed, but Commission Staff would not discuss the matter. Exhibit No. \_\_\_ (VRF-1T) at 25:3-7 and 28:18-22. Please comment.**

A. AWR agreed to the conditions placed on the Docket 010961 Account. Staff was unaware of the impending sale of the View Royal and AWR, not Staff, was in the best position to analyze the impact of the View Royal sale to AWR’s operations. AWR made several proposals to Staff after View Royal was sold, but provided no supporting justification. I do not recall refusing to discuss any proposal. I advised AWR that Staff did not agree with its proposals and I thought additional analysis was required before changes could be made. The testimony filed in this case is the first analysis I have seen regarding the effect of the View Royal sale on AWR and its customers. If AWR concluded that it needed additional revenue, it should have filed a petition with justification asking the Commission to amend its Order in Docket UW-010961 or filed a rate case with supporting justification.

1 **Q. Does Staff decide whether or not the Commission would revise the conditions**  
2 **set forth in a Commission order?**

3 A. No. As Mr. Fox and his advisors are aware, the Commissioners, not Staff, make  
4 the decisions regarding requirements placed on companies. Even if Staff  
5 disagrees with a proposal, Staff is always willing to present the matter along  
6 with a recommendation to the Commissioners at a regularly scheduled Open  
7 Meeting.

8  
9 **Q. Mr. Fox testifies that: "Relationships became strained due to the UTC's delays**  
10 **in funding the surcharge, refusal to even consider other necessary capital**  
11 **improvements, badmouthing AWR to DOH and constant criticism of our**  
12 **actions and financial condition. Through UTC's conversation with, and**  
13 **complaints to DOH, our relationship with DOH deteriorated rapidly." Exhibit**  
14 **No. \_\_\_ (VRF-1T) at 31:4-8. Please respond.**

15 A. Commission Staff, the Commission, and DOH all acted independently on the  
16 information available at the time decisions were made. Commission Staff does  
17 not dictate what the Commission or DOH will do. In discussions with DOH,  
18 Commission Staff has expressed concerns regarding AWR's operations, but we

1 do not “badmouth” any company regulated by the Commission. Mr. Fox’s  
2 conspiracy theory does not hold up.

3  
4 **Q. Mr. Fox criticizes Staff for not being more helpful and cooperative, and**  
5 **recommends that the Commission could instruct Staff to be more helpful to**  
6 **the Investor Owned Utilities. Exhibit No. \_\_\_ (VRF-1T) at 41:3-5. Please**  
7 **comment.**

8 A. AWR's desire for Staff to spend more time advising and consulting is not  
9 unique. Except for water companies that Staff is investigating for jurisdictional  
10 reasons, virtually everyone I talk to wants the Staff and the Commission to do  
11 more. The Commission simply does not have sufficient Staff to do what  
12 everyone would like us to do.

13 Prior to 1996, the water section had sufficient Staff to allow us to work  
14 much closer with small water companies, and to provide more education and  
15 guidance. However, due to budget constraints, staffing was decreased by five  
16 FTEs. We knew Staff could no longer work as closely with companies, and that  
17 companies would need to shoulder more responsibility for developing issues  
18 and rate cases without Staff assistance. We also knew that decreasing our costs



1 and services, would shift costs from the Commission to regulated water  
2 companies and through to customers in the form of higher rates.

3 Despite these extraordinary limitations, Staff is able to resolve virtually all  
4 issues informally. With very few exceptions, Staff and the companies have  
5 reached compromise without going to hearing. In fact, this will be only the fifth  
6 water rate case to go to hearing in the last 11 years. Unfortunately, this case will  
7 be the third time that AWR will be involved in a formal hearing in the last six  
8 years.

9

| <b>Summary of Water Company Hearings</b> |                                  |   |
|--|----------------------------------|---|
| <b>Year</b>                              | <b>Company</b>                   | <b>Docket</b>                                     |
| 1995                                     | Rosario Utilities, Inc.          | UW-951483   |
| 1998                                     | AWR                              | UW-980072, UW-980258, UW-980265<br>(consolidated) |
| 2000                                     | AWR                              | UW-000405   |
| 2001                                     | Rainier View Water Company, Inc. | UW-010877   |
| 2004                                     | AWR                              | UW-031284, UW-010961 (consolidated)               |

10

11 I think our limited Staff works effectively with most companies to resolve  
12 most issues quickly, fairly, and informally. Based upon my personal experience,  
13 Staff advice is often viewed as "helpful" if the advice supports what a company  
14 wants to do or as "criticism" if the advice is contrary to what a company wants to  
15 do.

1 I share Mr. Fox's concerns and frustration regarding the time and  
2 resources required to resolve AWR matters in a formal process and strongly  
3 believe that pattern is not in the best interest of customers, AWR, the  
4 shareholder, or the Commission. Although I am proud of the extraordinary  
5 record Staff has achieved, I believe there is always room for improvement. We  
6 continue to review ways to improve our rate audits, educate companies, and  
7 develop simplified processes.

8  
9 **Q. Mr. Fox suggests that there ought to be different rules for small companies.**

10 **Exhibit No. \_\_\_ (VRF-1T) at 42:12-18. Please comment.**

11 A. Different rules generally mean different results, which might benefit the  
12 company or the customer compared to the current system. The current system is  
13 designed to provide due process considerations to protect both customers and  
14 companies. Those due process considerations can be lengthy, expensive, and  
15 frustrating to everyone, including customers, companies, and Staff. With few  
16 exceptions, even small water companies are able to function effectively within  
17 the current regulatory structure.

1 Q. Mr. Fox comments that the process to resolve matters at the Commission is  
2 incredibly slow, and expensive, and that reasonable people would be able to  
3 work out their differences. Exhibit No. \_\_\_ (VRF-1T) at 4:5-6 and 42:3-11.  
4 Please comment.

5 A. I share Mr. Fox's concerns and agree with him that the formal hearing process is  
6 lengthy, expensive, and frustrating. However, reasonable people can disagree.  
7 The formal hearing process provides a carefully balanced process to resolve  
8 contentious issues.

9 Mr. Fox (35:14) states that AWR is a "special" case. Exhibit No. \_\_\_ (VRF-  
10 1T) at 35:14. I agree. Staff has spent a far disproportionate amount of time  
11 working with AWR on issues and cases. With this case, the Commission will  
12 have heard more formal cases with AWR than the entire rest of the regulated  
13 water industry over the last eleven years. I think that I have spent more time  
14 attending AWR customer meetings and discussing AWR issues with DOH than  
15 the entire rest of the water industry. These trends ought not to continue.  
16 However, changing this pattern presents a formidable challenge to both AWR  
17 and Staff.

1 I disagree with Mr. Fox's statement that the UTC staff does not answer  
2 questions in a timely manner. Staff typically answers questions in a reasonable  
3 amount of time.

4  
5 **Q. Mr. Fox discusses AWR's inability to recover its investment in his testimony.**  
6 **Exhibit No. \_\_\_ (VRF-1T) at 41:19 to 43:8. Please comment.**

7 A. Mr. Fox's discussion is focused on recovering past operating losses, not  
8 recovering past investment. Recovery of past operating losses, also referred to as  
9 retroactive ratemaking, is prohibited by statute. Mr. Fox confuses UTC policy  
10 with statute. I disagree with Mr. Fox's characterization that "UTC's actions are  
11 the cause of our loss." Exhibit No. \_\_\_ (VRF-1T) at 42:22. Mr. Fox seems to refer  
12 to the Commission not granting rate increases at the level he requested.

13 The company requesting a rate increase must demonstrate that the  
14 company needs additional revenue. Based upon Staff's review of the company's  
15 supporting justification, Staff recommends that the Commission either allow the  
16 proposed filing to go into effect as proposed, or suspend the filing if Staff  
17 believes the company has failed to demonstrate that the proposed rates are fair,  
18 just, reasonable, and sufficient.

1           The following table shows the history of AWR rate filings. In each case,  
 2           Staff analyzed the information provided by AWR and made recommendations to  
 3           the Commission. In the case of formal hearings, the Commission's decision  
 4           making was aided by substantial records, provided by both AWR and Staff.

5

| <b>SUMMARY TABLE OF AWR RATE CASES</b> |                   |                 |   |                                  |
|--|-------------------|-----------------|---|----------------------------------|
| <b>Docket No.</b>                      | <b>FLAT RATES</b> |                 |   | <b>Disposition</b>               |
|  | <b>Current</b>    | <b>Proposed</b> | <b>Effective</b>                                |                                  |
| UW-960891                              | \$22.50           | \$30.00         | \$30.00   | Effect by<br>Operation of<br>Law |
| UW-961105                              | \$15.00           | \$30.00         | \$30.00   | Effect by<br>Operation of<br>Law |
| UW-971237                              | \$30.00           | \$35.00         | \$32.40   | Negotiated                       |
| UW-980072                              | \$32.40           | \$37.60         | \$29.40   | Hearing                          |
| UW-991392                              | \$29.40           | \$36.46         | \$34.37   | Settlement                       |
| UW-000404                              | \$34.00           | \$42.13         | \$34.37   | Withdrawn                        |
| UW-010961                              | \$34.00           | \$45.51         | \$37.47 with set aside<br>\$33.07 w/o set aside | Settlement                       |
| UW-031284                              | 37.47             | N/A             | \$33.07   | Partial<br>Settlement            |

6  
 7           In each case, the Commission made its decision based on the information  
 8           presented. In each case, AWR failed to demonstrate that it needed revenues  
 9           greater than what the Commission allowed to go into effect by operation of law  
 10          or set after hearing. Although AWR criticizes the Commission because AWR  
 11          had to wait for the Commission to "catch up," I note that AWR's business practice  
 12          of purchasing and selling water systems resulted in constantly changing

1 operational requirements that may have affected AWR's ability to accurately  
2 demonstrate to the Commission known and measurable pro forma adjustments.

3 One of the problems in analyzing AWR's operations has been the rapid change in  
4 its operations.

5 AWR attempts to place all responsibility for delays on the Commission.

6 There is an inherent delay in preparing a rate request using an historical twelve-  
7 month test period. The Commission's review requires another 30 days by  
8 statute. Further delay may occur if the Commission suspends the filing.

9 Suspensions generally occur when Staff and a company reach different  
10 conclusions. Unless one party is entirely successful in achieving its position after  
11 hearing, both parties must share responsibility for the delay.

12  
13 **Q. Mr. Fox states that AWR has never had rates that were sufficient to maintain**  
14 **its systems (Exhibit No. \_\_\_ (VRF-1T) at 33:12) and that the Commission has no**  
15 **interest in allowing AWR sufficient personnel to paint, install repair parts, do**  
16 **building or grounds maintenance or provide a budget to keep its systems**  
17 **maintained in the manner that customers legitimately expect. Exhibit No. \_\_\_**  
18 **(VRF-1T) at 30:12. Please comment.**

1 A. I disagree. In each rate case, contrary to normal rate making principles, but in  
2 recognition of the continuing struggle AWR faced in providing adequate  
3 maintenance of its systems, the Commission accepted AWR's proposed pro  
4 forma adjustments to hire additional employees. In each case, AWR failed to  
5 hire and maintain those additional employees to do the work AWR said was  
6 needed. Mr. Ward discusses this issue in more detail in his testimony. Exhibit  
7 No. \_\_\_ (JAW-24T) at 7:6 to 9:2.

8

9 **Q. Do you have any comments on AWR's petition for mitigation of the penalty?**

10 A. Yes. This is not the first time that AWR has failed to comply with a Commission  
11 order. Mr. Fox states that AWR had some problems with "mishandling of funds"  
12 intended for the surcharge account, partly because of AWR's "misunderstanding  
13 the importance of strict and absolute requirements, but mostly because the funds  
14 were simply not available when the proper time of transfer occurred." (Exhibit  
15 No. \_\_\_ (VRF-1T) at 17: 20).

16 AWR's handling of the Docket 010691 Account has been unfortunate.  
17 AWR should have addressed the Docket 010961 Account issue soon after it  
18 determined in early 2002, that the conditions on the funds would prevent AWR  
19 from using the funds for the intended purpose. AWR apparently received poor

1 advice or misunderstood the advice from its accountant regarding the tax  
2 implications of the View Royal sale. AWR did not critically analyze the effect of  
3 selling the View Royal system on its revenues and expenses until after the sale  
4 AWR chose to use the entire proceeds from the View Royal sale, plus incur  
5 additional debt on its line of credit, for the purpose of paying down the owner's  
6 debt. AWR chose not to file a rate case, even after it determined in late 2002 that  
7 its revenues were insufficient.

8 In this case, Mr. Fox seems to suggest that the Commission should not  
9 penalize him because he only spent the funds on unauthorized purposes after  
10 carefully discussing the matter with his consultants. I recommend the  
11 Commission deny Mr. Fox's petition for mitigation of penalty.

12 **Q. Does that conclude your testimony?**

13 **A. Yes.**