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December 4, 2023

SENT VIA EMAIL (to comments@utc.wa.gov)

Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, WA 98504-7250

Re: ***Olympic Water and Sewer, Inc. (OWSI) Request for General Rate Increase***
Docket UW-230132

Dear WUTC Commissioners:

Intervenor Port Ludlow Village Council (PLVC) submits these comments in advance of the December 7, 2023 Open Meeting regarding the above-referenced matter, in which OWSI is requesting a 23.3% general rate increase coming on the heels of general rate increases of 7.8% in 2014, 14.2% in 2019, and 7.4% in 2021, amounting to a cumulative increase of 63% since 2014, far more than the 27% of cumulative general inflation over that time period.

The Commissioners' Order 01, dated June 16, 2023, stated, among other things, that:

- PLVC “has raised important issues that deserve full consideration” (¶ 7);
- the Commissioners “are unable to conclude at this time whether the approved rates will ultimately be excessive and thus require a refund to the Company’s customers” (¶ 5);
- OWSI “bears the burden to prove that the proposed increases are fair, just, reasonable, and sufficient” (¶ 7); and
- OWSI “has not yet sufficiently demonstrated that the tariff revisions would result in rates that are fair, just, reasonable, and sufficient” (¶ 12).

Accordingly, the Order directed staff to “institute an investigation of Olympic Water and Sewer, Inc.’s books, accounts, practices, activities, property, and operations as described above” (¶ 22).

Meanwhile, the Order allowed the proposed rates “to become effective on June 19, 2023 on a temporary basis, subject to refund if the Commission determines that different rates will be fair, just reasonable, and sufficient” (¶ 19).

Contrary to the directive in Order 01 that Commission staff was “to institute an investigation of [OWSI’s] books, accounts, practices, activities, property, and operations,” staff took the position that such an investigation was unnecessary since staff was already satisfied that an even larger rate increase would have been justified, and therefore instead of instituting its own investigation staff would merely respond to specific questions raised by PLVC or by the Office of Public Counsel.

The parties submitted and responded to various requests for information, and met in person or via Zoom on multiple occasions to discuss the issues. On September 26, 2023, PLVC sent the other parties an Excel workbook and accompanying written narrative setting forth a number of remaining

“questions and concerns” about OWSI’s accounting practices and submissions and about Commission staff’s review of those submissions. Copies of that Excel workbook and written narrative are submitted herewith as Enclosures 1 and 2, respectively.

Neither Commission staff nor OWSI have provided written answers to PLVC’s 9/26/2023 “questions and concerns.” For example, PLVC pointed out many serious, unexplained anomalies in OWSI’s accounting as reflected in the Annual Reports filed with the Commission, indicating there were serious flaws and inconsistencies in OWSI’s accounting practices. We were surprised by the staff’s explanation that the Annual Reports do not matter since they are not reviewed and are not considered at all in evaluating a proposed rate increase. The Annual Reports are the only way that ratepayers can review and evaluate how a water utility is doing every year. We have used them for comparisons and to point out some of the unexplained anomalies in OWSI’s accounting.

Staff’s approach appears to be willfully ignoring the problem that if there are significant flaws in a utility’s underlying accounting practices then the numbers submitted by the utility in support of a rate increase are likely to be similarly flawed and unreliable. That is why it made sense for the Commissioners to order staff to institute an investigation of OWSI’s accounting practices, instead of blindly assuming that OWSI’s accounting was reliable.

A more specific example of OWSI’s questionable accounting relates to how upper-level management costs (G&A) of OWSI’s parent company Port Ludlow Associates, LLC (PLA) are allocated, both (i) among OWSI and PLA’s other business operations, and (ii) within OWSI, between the regulated water utility and the unregulated sewer utility. For the test year 2022 PLA charged OWSI a “G&A management fee” of \$426,155, of which 67% (\$285,524) was allocated to OWSI Water and 33% (\$140,631) was allocated to OWSI Sewer. According to financial information provided by PLA for 2022, OWSI utility operations accounted for only 12% of PLA’s revenues and 6% of PLA’s expenses compared to PLA’s other business operations (hospitality services, marina operations, golf course operations, home and land sales, and rental property operations), yet OWSI was allocated 65% of PLA’s upper-level management costs. See Enclosure 2, at 30-32.

Staff has said it sees no need to question that allocation, because fifteen years ago in 2008 a staff member looked carefully into the allocation of PLA management expenses to OWSI and found it to be acceptable. However, in 2008 the real estate industry was in a deep recession and PLA had almost completely ceased its home building operations, so that activity generated little or no revenues or expenses in that year. In contrast, in 2022 PLA’s home building and land sales operations generated 52% of PLA’s revenues and 55% of its expenses. See Enclosure 2, at 30. Even if it made sense to allocate 65% of PLA’s upper-level management costs to OWSI in 2008 when home-building was at a standstill, there is no rational basis for using that same allocation in 2022 when home-building accounted for a majority of PLA’s revenues and expenses and OWSI utility operations accounted for only 12% of PLA’s revenues and 6% of its expenses.

Similarly, the 67%-33% allocation of such management expenses between OWSI Water and OWSI Sewer is said to be based on a staff review performed back in 2008, which resulted in a 74%-26% split at that time, and a subsequent revision in 2019 resulting in the current 67%-33% split. However, detailed OWSI employee time records for 2022 show that OWSI employee time was split almost exactly 50-50 between Water and Sewer operations. In the absence of actual management time records showing time spent on water issues versus sewer issues, using the split between employee time spent on water operations or sewer operations would be a more reasonable way to allocate management time

between the two kinds of utility operations. Perhaps another way to allocate management time between water and sewer operations would be on the basis of comparing water revenues to sewer revenues. According to information provided by OWSI, in 2022 sewer revenues were about twice as much as water revenues (see Enclosure 2, at 8), suggesting that a 33-67 split between water and sewer management expenses would be more appropriate than a 67-33 split. In any event, the notion that a WUTC staff member worked closely with PLA's controller fifteen years ago in 2008 and concluded at that time that a 74-26 split was appropriate should somehow justify the present 67-33 split, is less than persuasive.

Since the start of the rate-setting process, PLVC has asked repeatedly for copies of any verified written agreements or summaries of affiliated interest financial arrangements between OWSI and PLA, and copies of all written modifications or amendments thereof, as explicitly required by WAC 480-110-545 to be filed by OWSI before any such agreements or modifications can become effective, but we have received none.

Another example of OWSI's questionable accounting relates to the treatment of a \$21,100 loan fee for the new water treatment plant. OWSI's general ledger shows a payment of that loan fee as having been made on 12/31/2022, and in its PFIS submitted in support of the present rate increase request OWSI claimed that payment as an "expense" for 2022. When questioned by PLVC about that alleged "expense" item, OWSI stated that it "would agree and not object to the removal of this amount from the Company's Profit & Loss (P&L) statement and recategorizing it as a Capital Asset." See Enclosure 2, at 12-13. When PLVC asked Commission staff how that admission by OWSI would affect staff's analysis, staff's response was that that issue would be considered only if OWSI filed a revised revenue requirement. See Enclosure 2, at 13. However, the problem is not only that OWSI incorrectly categorized the loan fee as an "expense" paid in 2022, but that no such payment was ever made. Instead, according to information provided by the Department of Health, the loan fee is amortized over the life of the loan and is being paid periodically, along with the payments of principal and interest. The general ledger entry showing a payment in that amount on 12/31/2022 was a mistake. If OWSI's general ledger is not a reliable accounting record, it is difficult to have much confidence in OWSI's other accounting records that are in large part derived from the general ledger.

A further example of questionable accounting relates to federal income taxes. In 2018 the Annual Report filed by OWSI Water showed a tax payment of \$65,177. To have a tax liability in that amount, the water utility would have to have had net earnings before taxes of \$310,367, but the Annual Report showed a loss of \$24,490. See Enclosure 2 at 5. This should have set off alarm bells for staff but was apparently ignored. For 2022, OWSI reported owing federal income taxes of \$39,985.84, but the general ledger instead shows a federal income tax refund of \$39,900. See Enclosure 2, at 6-9. If there is an explanation for this anomaly, it has not been provided. Staff says that income taxes are not relevant to consideration of a rate increase request. Even if that were so, it would not explain why staff is not concerned about the reliability of OWSI's accounting practices that apparently produce such anomalous results.

As explained in more detail in the 9-26-2023 "Questions and Concerns" narrative (Enclosure 2 submitted herewith), PLVC has raised many other issues about OWSI's questionable accounting

practices, including issues relating to non-existent tax expenses, payments made to PLA's investors in San Francisco and Hong Kong that were claimed as "management fees" but actually were returns on investment rather than payments for management services rendered to OWSI, and numerous accounting inconsistencies. Some of those inconsistencies may be for inconsequential amounts, but others are not. Collectively, they again call into question the reliability of OWSI's accounting practices, and reinforce the need for Commission staff to comply with the Commissioners' June 16 Order "to institute an investigation of [OWSI's] books, accounts, practices, activities, property, and operations."

PLVC freely acknowledges that it lacks the expertise, experience, and resources to investigate OWSI's accounting practices adequately. That is why PLVC, and the water ratepayers whose interests we seek to protect, must rely on the Commission and its staff, as well as the Attorney General's Office of Public Counsel, to perform the necessary financial analysis. Nevertheless, merely to illustrate how these issues might bear on an appropriate rate increase decision, submitted herewith as Enclosure 3 is an Excel workbook, including a spreadsheet with supporting documentation, showing what an arguably appropriate rate increase might look like based on more reasonable assumptions. Allan Keisler will be available at the December 7 Open Meeting to answer any questions about these documents.

We support the suggestions made by Public Counsel for ways to improve the water rate case review process, but we cannot support the recommendation to allow OWSI's provisionally approved rate increase to become permanent. As the Commissioners found explicitly in the June 16 Order, OWSI bears the burden of proving that the proposed rates are appropriate, and it has not met that burden. No final rate increase should be allowed unless and until that burden has been satisfied.

Accordingly, PLVC requests as follows:

(i) that Commission staff be ordered to comply with the directive set forth in the June 16 Order to institute a robust, full-throated investigation of OWSI's "books, accounts, practices, activities, property, and operations," instead of merely responding to specific issues raised by PLVC or by Public Counsel;

(ii) that staff be directed to issue a written report on the results of its investigation and promptly provide that report to PLVC and Public Counsel for review and comment;

(iii) that following the issuance of staff's final report on the results of its investigation this matter be docketed for a further Open Meeting to consider how to proceed; and

(iv) that no decision be made on whether the proposed rate increase will be allowed to become permanent or rolled back wholly or in part, until that further Open Meeting.

We appreciate the Commissioners' consideration of these comments.

Respectfully,

PORT LUDLOW VILLAGE COUNCIL

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