



CITY  
OF

# FALLS CHURCH

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June 27, 2011

Mr. Philip W. Allin  
Chairman  
Fairfax Water  
8570 Executive Park Avenue  
Fairfax, Virginia 22031

Dear Chairman Allin:

Thank you for your letter of June 14, 2011, to Mayor Baroukh. This response has been prepared in consultation with City Council. I appreciate your suggestion of a meeting to discuss a potential new path forward, as we have sought such discussions with Fairfax County officials, as well. However, for any such discussions to be effective, I need your concurrence on two conditions.

First, if Fairfax Water wishes to have discussions with the City regarding its water system as you appear to suggest in your letter, the City requires Fairfax Water's assurance that it will not pursue any legal action against the City with respect to the rates it is advertising based on the May 27, 2011, Water Rate Study. The City and its water customers need such assurance before the City considers taking final action on July 11, 2011, to approve the recommended rate increase. It is not in the interest of the City or its customers for City Council to approve a rate increase only to have Fairfax Water challenge that rate increase after the fact. Second, the City also requires that a Fairfax County official with authority to represent the County Board of Supervisors be present at all discussions.

These two conditions are necessary if discussions between us are to be productive. The City looks forward to meeting with you and working with Fairfax Water in good faith to establish a new path forward.

A significant portion of your letter covers issues separate from your suggested "new path forward." It is necessary that I respond to a number of these issues raised in your letter. The purpose of our requesting your comments on the May 27 Rate Study was to provide an

opportunity for Fairfax Water to confirm that it fully complies with Judge Ney's January 6, 2010, Decree. The City believes it does.

The Judge ruled that the City is "enjoined from transferring any moneys from its water fund to its general fund for purposes unrelated to the water system, including the "management fee" transfer for the City's Fiscal Years 2009 and 2010," other than "reasonable direct and indirect costs associated with operating the water system." The Rate Study and the proposed rates are consistent with and do not violate the Court's ruling.

The Judge also decreed that the "City must comply with Section 13.09 of the City Charter in setting water rates that, in the judgment of the City Council, will result in receipts equal to expenses (including any future expenses of the water system)." The Rate Study documents the revenue requirements necessary to meet current and future expenses of the City's water system.

The Judge decreed that City Charter § 13.07 is "unconstitutional *to the extent* it permits the City to transfer water moneys to the general fund in a manner inconsistent with paragraphs two and three." (Emphasis added.) The rate study documents that there is no longer any such transfer pursuant to City Charter § 13.07.

In your letter, you present no argument that the Rate Study runs counter to Judge Ney's January 6, 2010 ruling. Instead, you claim that the City's proposed rate increase is "significant" and "substantial." In fact, the City has kept water rates flat for six years. Over this period of time, Fairfax Water has raised its rates 33 percent and Fairfax County has raised sewer rates over 80 percent. The City is proposing to raise its rates eight percent to fund operating costs and existing and future capital costs. Even with the proposed rate increase, the City's water rates will be below average for the national capital region and lower than two-thirds of the public water utilities in Virginia. In any event, your letter acknowledges that the "primary reason" for Fairfax Water being able to charge a lower unit cost is that you have "significantly larger economies of scale," which, if true, makes the City's proposed rate increase quite modest in comparison to Fairfax Water's recent rate increase.

Fairfax Water next questions the recommendations in the Rate Study that the proposed rate increase be used to restore water fund reserves. You write "we do not quarrel with the wisdom of having reserves in the water fund. You should." Rather, you argue that such reserves should be funded out of the general fund instead of the water fund. There is no basis for this argument under Judge Ney's ruling. In *FCWA v. City of Falls Church*, the Court enjoined the City from transferring a return on equity for FY09 and prospectively. The Court did not rule that the City could not establish reserves for the water system as a part of its appropriate and proper operating expenses.

You also challenge the City's tap fees. Municipal and Financial Services Group ("MFSG") reviewed these fees as part of its study and determined that the existing tap fees, including availability fees, are sufficient to cover the costs of new connections and

system expansion. Therefore, our availability fees are not proposed to change. The Rate Study focuses on those rates for which a change is recommended by MFSG.

With respect to tap fees, it appears you are arguing that the City should set these rates at an artificially high level. Just last year, Fairfax Water argued that there is a competitive market, as defined by antitrust statutes, for water service in the City's traditional service territory. If so, any correspondence by you to any City official on the matter of rates, urging the City to increase its tap fees to a level similar to yours, is a prima facie attempt at price collusion under the very antitrust statutes that you cited in earlier litigation. The City has not, does not, and will not set its rates or fees based on any consideration of Fairfax Water's opinions. The City will set its rates based on sound utility rate making.

To summarize, the purpose of our requesting your comments on the Rate Study was to confirm that its methodology and findings are in conformance with the January 6, 2010, ruling by Judge Ney. You have not raised any such concerns in your June 14 letter. Therefore, the City Council will proceed with 1<sup>st</sup> reading of a new rate setting ordinance on June 27, with 2<sup>nd</sup> reading and consideration of final adoption scheduled for July 11.

Your letter raises several additional points, aside from rates, that require a response. While we thank you for sharing the results of your research on MFSG's SCC registration status, please be assured that we are satisfied with MFSG's registration status. MFSG is a nationally recognized and respected utility rate expert, whose professional reports have been upheld by the Supreme Court of Virginia. The City Council will give MFSG's recommendations full consideration.

The bottom line is this: The City of Falls Church and Fairfax Water both maintain world class water facilities, as our customers expect and demand. The City enjoys a long-term partnership with the Washington Aqueduct, which provides Falls Church customers with reliable, secure, and clean drinking water that meets or exceeds all EPA standards. You are aware of this because Fairfax Water relied on the City system for much of its water needs for most of its history.

The City and County benefited from a cooperative relationship for the majority of our histories. This was interrupted in 2006 by an effort by Fairfax Water, first, to buy the City water system and second, when that did not proceed as Fairfax Water desired, to cherry-pick large developments in the City's traditional service territory to induce the City into a sale. As Judge Ney correctly noted in his opinion letter last year, the lawsuits brought by Fairfax Water against the City were "ultimately about power – market power – more than anything else." The City naturally contested these actions.

The City has always been open to consideration of a new status quo regarding its water system, but it must be reached through mutual agreement. For this to occur, the adversarial and litigious atmosphere with respect to water issues must end. Our experience over the past five years requires that I state the obvious: a litigious approach on the part of Fairfax Water or Fairfax County toward the City will not produce results that benefit the residents and businesses we serve. If Fairfax Water is interested in pursuing a new

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relationship with the City regarding its water system in accordance with the conditions I have outlined above, then I look forward to hearing from you and discussing a new path forward with you.

Sincerely,

A handwritten signature in cursive script that reads "Cindy L. Mester". The signature is written in black ink and is positioned above the printed name.

Cindy Mester  
Acting City Manager

cc: Wyatt Shields, City Manager  
City Council of Falls Church, Virginia  
Brenda Creel, Director of Public Utilities  
Fairfax County Board of Supervisors  
Anthony H. Griffin, County Executive  
Fairfax Water Board of Directors