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July 8, 2011

By E-Mail & US Mail

Mayor Nader Baroukh
City of Falls Church
300 Park Ave
Falls Church, VA 22046

**Falls Church's Proposed Water Rate Increase,
MFSG's Rate Study, and a Suggestion for a New Path Forward**

Dear Mayor Baroukh:

I have received the June 27, 2011 response to my letter (commenting on the City's water rate study), from your Acting City Manager, Cindy Mester. The City requests two preconditions to sitting down with us to discuss a new path forward that could result in a better, more economical, and more robust water system for all of our respective customers.

First, you request assurance that Fairfax Water will not file suit if the City adopts the proposed commodity rate increase recommended by MFSG. Fairfax Water and all other customers of the City of Falls Church who reside outside of the City have no voice when it comes to how the City's water system is managed. While we have no current plans to challenge the proposed rates in court, when this is the only recourse available, it would be irresponsible to provide the assurance you have requested. We can agree, if you choose to meet with us, that our respective representatives will be able to speak freely with one another, without fear that anything said by one side will be used against the other if there is ever any future litigation between us. Both sides should be free to speak candidly.

Your second precondition asks us to promise something over which we have no control: "that a Fairfax County official with authority to represent the County Board of Supervisors be present at all discussions." Fairfax Water is separate from the Board of Supervisors and is an independent political subdivision of the Commonwealth of Virginia. We are certainly open to

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including Fairfax County in our discussions with you, although if the City and Fairfax Water cannot reach agreement on a new path forward, adding the County to the mix is not likely to make any difference. In the meantime, your request for the County's participation is properly directed to the Board of Supervisors.

Ms. Mester's letter does not address the main concerns we raised about the study. The City does not explain how a water system that has been so profitable under the current rates now needs such a large cash infusion. Even though those rates were adopted in 2005, they were throwing off millions of dollars a year in profits, including through last year. MFSG first justified the rate increase by including a 7.8% return on equity in the revenue requirements. Recognizing that that would have violated Judge Ney's decree, MFSG deleted the profit margin but came up with additional reserve requirements instead, recommending exactly the same rate increases it originally proposed. This undermines the study's credibility. And neither MFSG nor the City answered our original question about why your profitable system is now unprofitable. Simply repeating that the rates have not been raised since 2005 does not answer the question because those rates have consistently thrown off millions of dollars in surplus profits, including through last year.

Ms. Mester's letter also fails to address our point that increasing the reserve requirements and funding them through a rate increase makes the City's water customers pay twice for the same reserves, given that at least \$58 million in prior, surplus reserve money was diverted from the water fund before FY 09. Creating a new reserve requirement in 2011 because money was diverted from the water fund before 2009 amounts a new circumstance that did not exist at the time of Judge Ney's decree. While your new proposal is one step removed from the direct "taxation without representation" that Judge Ney struck down as unconstitutional, it is but a very small step.

Ms. Mester's letter also misconstrues our question about the failure of MFSG's study to explicitly address the adequacy of the City's tap fees, which appear to be artificially low because they have not been adjusted in many years. We were not advocating that the City's tap fees be set "artificially high," as Ms. Mester stated. We were simply pointing out that *artificially low* tap fees lead to *unnecessarily high* commodity charges. They make your existing customers (including Fairfax Water) subsidize new customers. While Ms. Mester asserts that MFSG evaluated all of the City's tap fees against actual costs, we saw no evidence of that in the rate study. And the City Manager has refused to make public the earlier drafts of that study, notwithstanding the City's assurance of "transparency."

It was frankly not productive for Ms. Mester's letter to suggest that Fairfax Water is to blame for prior legal disputes between us. She overlooks that it was the City that commenced the litigation in 2007 without prior warning to Fairfax Water. But those matters are in the past. We believe that Judge Ney's injunction ruling in January 2010, and the February 25, 2010, consent decree, have put those differences behind us.

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I remain hopeful that substantive discussions between Fairfax Water and the City could lead to benefits for all of our water customers. If you agree, I look forward to hearing from you at your earliest convenience.

Very truly yours,

A handwritten signature in cursive script that reads "Philip W. Allin".

Philip W. Allin
Chairman

cc: Members, Falls Church City Council
Wyatt Shields, City Manager
Members, Board of Supervisors of Fairfax County
Anthony H. Griffin, Fairfax County Executive
Members, Fairfax Water